A Comparison between the English private Company and the Swiss Société à responsabilité limitée

with special regard to questions of liability

Inaugural Dissertation

submitted to the High Faculty of Law and Economics
of the University of Berne
to obtain the degree of Doctor iuris utriusque

by

Roger Anker
of Ins/Switzerland

Printed in Switzerland by Stämpfli & Cie. Berne . 1956

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«On juristic elegance we do not pride ourselves, but we know how to keep the roof weather-tight.»
Maitland [1])

"If you go out of the station as you arrive at a little country town you can see the shop-sign of two little coal companies, a little hay and straw dealer, the farmer's supply company, a butcher, a chemist, all Private Limited Companies, the capital of which very often does not exceed £ 1000." [2])

It is a fact that in the building up of Great Britain's prosperity, in whatever respect it was done, the Private Companies have played a decisive part and were always extremely popular.

The Swiss S. à R. l. Law which is admittedly a good example of modern legislative skill, on the other hand, has been adopted by commercial circles in comparatively few cases and with a good deal of hesitation.

Our intention is to select a certain number of problems, the analysis of which will enable us to recognise some aspects of the solution devised in both legal systems and to give as far as possible reasons for the unequal popularity of a company form which is established for similar purposes in both countries.

Notwithstanding the angle from which we intend to look at English Law, namely from the Swiss standpoint, we have applied ourselves to consider English Law in its genuine features and method of approach, being aware of the danger of forcing it on a Procrustean bed of Continental theories and definitions.

Cambridge and Berne, January, 1953.

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[1]) Trust and Corporation, *Selected Essays*, p. 132.
[2]) *Minutes of Evidence* taken before the Company Law Amendment Committee, 1943 (Cohen Committee), 10th day, No. 4545, per Mr Robert F. Shepherd.

1. A complete account of the problems concerning the Private Company and the S. à R. l. could not be written within the compass of this paper without being inconveniently superficial. A selection of subjects has therefore been necessary which should make it possible in the end to draw some general conclusions regardless of loopholes created by the questions which were purposely omitted. Subject to special purposes of comparison where it was essential to go into details, we have also found it advisable to restrict the description of Swiss provisions to a minimum, presuming the knowledge of general principles of Swiss Law. We have thus gained some more room for considerations of English Law as being the foreign legal system contemplated from the Swiss standpoint.

2. In a *general part* the Private Company and the S. à R. l. will be considered from the historical and the economic point of view in their respective systems.

3. The structure of the *special part* is concededly inspired by continental conceptions; but this should not be detrimental to the English aspect of the problem, to the individual character of which we have devoted particular attention.

The subjects selected for our analysis are provisions as to

publicity,
raising of capital,
maintenance of capital,

these being topics which have been most carefully considered at different periods and with different aims by the legislature in either country.

4. Some brief remarks on a few problems have been appended. In particular, they outline the influence of Taxation Law on Private Companies.

The Law is stated as at the date of the preface.

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GENERAL PART

FIRST CHAPTER

THE HISTORICAL FOUNDATION

The present account is based on research into the problems with which the Legislator had to cope rather than into chronological details; but the different nature of the development in the two countries respectively necessitated a different approach. Thus it has been sufficient—for the points of comparison we have selected — to draw a few basic lines as regards Swiss Law, whereas we have been compelled to deal at considerable length with the genesis of the statutory recognition of English Private Companies which appears to have been left in some obscurity by the English writers.

§ 1. THE DEVELOPMENT IN SWITZERLAND BEFORE THE LAW OF JULY 1st, 1937

I. Problems of Legislation

As a rule the continental Legislators intended to create a new form of association which should answer not only the needs of an interrelation of natural interests, but should also have some specific influence on the balance and the development of association forms as they were established at the time when reforms of Company Law were devised. Owing to this double purpose the development was not to rest on the purely "organic" base of the existing forms, but could easily include new elements or combinations of old ones.

Although the learned Committees which elaborated the proposals were therefore comparatively free—thus sometimes embarrassed—in their selection of recommended systems and rules, the Swiss Legislator had the advantage of being restricted in his choice by the experiences made abroad with the G.m.b.H. or the S. à R. l., since Switzerland is surrounded by countries which have systems of Company Law similar to that of its own. The idea that a type of company should be created, uniting the advantages of incorporation, concentration of capital and limited liability (Société Anonyme) with those of personal and active co-operation (Sociétés de personnes—partnerships) was first crystallized in the German Law of 1892, the outcome of a long period of preparation. In this new Law the principle of basing the G.m.b.H. on the structure of the "Aktiengesellschaft" [1]) had prevailed over the proposals using the "offene Handelsgesellschaft" as a foundation [2]).

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[1]) Project HAMMACHER.
[2]) Project OECHSELHÄUSER.

A few years later, the Swiss conception, which was to remain unchanged until the time of the enactment, was already outlined in an article on the German G.m.b.H.[1]) criticizing the G.m.b.H. as containing too many measures of protection which may well be appropriate in the "Aktiengesellschaft" but do not really suit the much closer personal relationship between the members of the type of association for which the G.m.b.H. was intended. In the "Aktiengesellschaft" the members do not take part in the management, and their financial participation is strictly limited. Owing to the rigid internal organization which is therefore needed, enough security is granted externally by the fact that the liability of the company is limited to its capital. Moreover, subject to qualification shares, the directors do not necessarily participate in the shareholding and, thus having as principal aim the development of the business, they are automatically restricted by the clash of their own activities with the interests of the shareholders who are predominantly concerned with obtaining dividends[2]).

For a type of company, however, in which the owners of the capital are more or less linked actively and personally with the management, being themselves usually the directors, it was thought that an adaptation of the "Société en nom collectif" (partnership) was more appropriate where the members are controlling each other naturally, owing to their joint, direct and personal liability to the creditors. The cumbersome and rigid organisation of the "Aktiengesellschaft" is thus rendered superfluous[3]). The machinery of guarantee in the "Aktiengesellschaft" is replaced by the joint, direct and personal liability of the members.

This, in a few words, is how the problem of the S. à R. l. was approached on a purely theoretical level in the last decade of the 19th century, when in Switzerland no real need for such kind of association was yet perceptible. However, the recommendations of Prof. Wieland, which aimed in substance at introducing a "*sole trader*" or a "*société en nom collectif*" *with limited liability*, influenced decisively the Legislator in his work, all the more since Wieland's critique of the German system subsequently proved to be justified: although widely used, the form of the G.m.b.H. was the receptacle of various abuses prejudicial to its credit.

The German experience still had a further influence on the Swiss system (as well as on most of the Continental Laws). Having regard to the bad reputation of the G.m.b.H., the Continental Legislators were all particularly concerned with the introduction of *special measures of security for the benefit of the creditors* in order to guarantee the financial standing of their new creation. If such provisions have been sometimes over-emphazised, it is for a good part because they emanated from the reactionary attitude caused by the unfortunate example of the German G.m.b.H.

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[1]) Prof. C. Wieland, *Zeitschrift für schweizerisches Recht* (ZSR), Bd. 14, N.F., p. 205 et seq.

[2]) Frequently however, the directors are also shareholders, especially in the case of smaller companies.

[3]) Compare A. Gysin, "Bemerkungen zur Einführung der G.m.b.H.", in "*Festschrift für* C. Wieland", 1934, p. 179 et seq., quoting Prof. Wieland.

Subject to the main structural lines thus established, the Committees were able to accomplish some kind of "laboratory work", synthesizing the presumably most advantageous principles and provisions which were either newly devised or inspired by rules of existing company forms at home and abroad. The result has been a *free internal structure*, mainly established in the "statuts" by the members themselves, so as to keep them as much as possible independent of the strict organization of the S.A. which was not at all suitable for a form of association where the "intuitus personae" is to play an important part. The counterpart to this flexible structure which may—among other dangers for the creditors—facilitate returns of capital, is the *external, joint and subsidiary liability of the members* of the "Société en nom collectif", the liability being however *limited* to the amount of the nominal capital.

Art. 802 C.O. shows that the liability involves unlawful returns of capital and is therefore not restricted to losses caused by members failing to pay for their shares in full, as it is the case in French Law.

With this new form of company, it was intended, on a commercial level, to reduce the rapid movement towards concentration of capital by providing for small and medium sized businesses a type of company adaptable to their individual tendencies without, however, depriving them of all the advantages which the "Société Anonyme" could bestow upon them. Some of the elements of the "Société Anonyme"—it should be mentioned in passing—have been introduced into the system of the S. à R. l. for such reasons.

Furthermore the so-called "cartels" should receive an appropriate form of company and, from the point of view of legal policy, the opinion was that the largest possible variety of organizational forms was to be placed at the disposal of the citizens. Here again German Law with its twelve different forms of companies may have influenced Swiss Legislation.

II. On the necessity of the introduction of the S. à R. l. in Swiss Law

Finally we shall endeavour to give some reasons why the S. à R. l. was introduced into the commercial circles so long after the German G.m.b.H. In other words we shall analyse some factors which at a certain time rendered the creation of a new company necessary. We are aware of the fact that German Law had to undergo an early development owing to the sudden rise of German colonial policy in the eighties of the last century and that a great number of colonial enterprises were at a loss when they searched for a form of company adapted to their needs. The Law regarding the "Aktiengesellschaft", which at first sight seemed to be suitable, had just shortly before been amended in 1884 and the new Law rendered it more difficult and cumbersome to float an "Aktiengesellschaft" with regard to structure and expenses. Smaller businesses could therefore no longer afford to form or to carry on business as "Aktiengesellschaft", although it was strongly needed to maintain some of its advantages. Given these facts,

we intend to insist—for the purposes of our comparison—on the position of the "Aktiengesellschaft" type in the respective Company Law systems. The more the "Aktiengesellschaft" type is specialized to accomodate large capital enterprises and is taken from the private into the public sphere, the larger becomes the gap between the "public company" and the "partnership" type in which there is no longer any possibility of existence for small concerns depending on incorporation and limited liability. Hence, if the economic development should not be hampered, the gap had to be filled. This has been done through the introduction of the G.m.b.H. The subsequent analysis of English Law shows similar trends.

In Switzerland, however, the "Société Anonyme" type has always maintained its comparatively free form and small concerns have been able to carry on business in that form without marked difficulties.

The introduction of the S. à R. l. type of company has therefore never been a necessity upon which depended the prosperity of economic life. Whereas the German G.m.b.H., as much as the English Private Company, supply beyond doubt a need felt by the commercial world [1]), no such feeling has grown in Switzerland during the 15 years of the existence of the S. à R. l.: thus the S. à R. l. was introduced into the C.O. comparatively late, for the Legislator was not compelled by necessity, but solely on the ground that such an innovation was useful. Several reasons for this have been set out above. One more consideration should be mentioned here which may have accelerated the final steps towards the enactement. Swiss Law had to be adapted to the development of international commercial Law, having regard to the fact that the foundation of a S. à R. l. on Swiss territory was prohibited until the Law of 1937, whereas any foreign "Private Company" was entitled to have registered branches of its business in Switzerland.

§ 2. THE SO-CALLED «PRIVATE» COMPANY BEFORE THE COMPANIES ACT, 1907

"Ignored by the Legislature, seldom figuring in the Courts, the (so-called) 'private' Company has for the last 30 years (1880–1907) been multiplying unobserved, quickly revolutionising our commercial organization, and moulding itself to the requirements of the business world [2])."

This is already enough to amaze the continentally trained lawyer. How was the creation of a new type of company possible outside the Statute Book and why did the Courts sanction its existence? This will be the first object of our investigation.

In the second place we intend to establish—as we have done for Swiss Law—the factors which eventually caused the statutory recognition of the "Private" Company and its subsequent reform.

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[1]) "Rechtsbewusstsein."

[2]) *Law Quarterly Review,* vol. 26, p. 11 (1910), Edward Manson.

The term "Private Company", to begin with, was given a technical significance for the first time in the Companies Act of 1907 [1]). This is to be remembered when facts previous to this date are concerned.

The Companies Acts of 1855, 1856 and especially the Act of 1862 [2]), which introduced and developed the principle of limited liability, seemed to have been provided only for big trading associations. The notion that the form of "limited liability" could also be used for smaller concerns of a private character was "discovered" only later, that is when the *sole trader* realised the advantages he could derive from limited liability and incorporation. The most serious barrier for him was, at the beginning, that in the intention of the Law, the number of members was not to fall below seven. The one-man company, however, soon received the benediction of the House of Lords in the classical *Salomon* v. *Salomon Case* [3]), notwithstanding the fact that the same case had been treated in the Court of Appeal as "a transaction which would be a scandal if legalized [4])". The situation was now that the subscription by at least seven members could be a mere formality, since a "balance of power" between the shareholders as regards their financial interests [5]) was not required.

Independently of the problem of a minimum number of members and of the extreme case of a one-man company, as in the *Salomon Case* which occurred comparatively late in the development, the Courts had recognized or at least accepted the presence of what they called "private companies".

"It was intended to be a 'private company', said Cotton, L. J., in 1881 [6]), that is, it was intended to carry on the business without calling in the public or issuing any shares except for the then existing shareholders..."

"This was a small company, what is called a 'private company'... the persons who composed it were not numerous, there being about 16 of them..., they did not contemplate appealing to the public...[7])."

Thus the "private company" of the early days was a small concern which did not apply to the public for its capital. It was either a family business or an industrial or banking partnership converted into a Joint Stock Company in which the whole of the shares were held by the former partners [8]). The Courts did not have any objections against the raising of money being restricted to a private sphere.

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[1]) Companies Act, 1907 (7 Edw. 7, c. 50).

[2]) Companies Act, 1862 (25 & 26 Vict. c. 89).

[3]) *Salomon* v. *Salomon & Co.*, [1897] A.C. 22. One member held the bulk of the shares and the other six (family-) members held one share each. Compare also *Law Quarterly Review*, vol. 26, p. 11–12.

[4]) *Broderip* v. *Salomon*, [1895] 2 Ch. 323.

[5]) *Salomon* v. *Salomon & Co.*, *supra*.

[6]) *In Re British Seamless Paper Box Co. Ltd.* (1881), 17 Ch. D. 467, at p. 469.

[7]) Per Lindley, L. J., *in Re Eddystone Marine Insurance Co.*, [1893] 3 Ch. 9 at p. 17.

[8]) Compare the *Salomon Case*, *supra*, at p. 43, per Lord Herschell.

In fact the "private company" was a *partnership* which, whilst keeping its private features, took advantage of the *incorporation* under the Companies Act in order to obtain the privileges both of limited liability and of continuity conferred on corporate bodies. That is why it has been accurately remarked that the "private" company is not so much a natural offshoot from the original stock of the English system, as a graft upon it [1]).

A judgement as that given in the *Salomon Case* and the recognition by the Courts of the incorporated "private" companies were both only conceivable because of the strong *liberal trends* which had ruled English Company Law since the middle of the 19th century. It is of some interest to contrast this extremely free and flexible approach with the conceptions ruling Company Law in Switzerland in the nineties. In 1896, when the G.m.b.H. still was of purely academic interest in Swiss Law, even the registration of a branch of a German G.m.b.H. was refused, apparently for reasons of "ordre public" [2]).

Two years later, however, the Federal Department decided to change its attitude towards foreign companies of the G.m.b.H. type, and the first registration took place in 1902 [3]). The example is a problem of conflict of Laws as regards domicile and residence of Associations [4]), but it shows how hermetically closed the opinion was against any form of association which would not correspond to the Law of the country.

II. The statutory recognition of "private" Companies

How has the step from toleration by the Judges to recognition in the Companies Act been accomplished?

Textbooks and articles are not very helpful on this question. Most of them put the recognition in the Act of 1907 [5]) as a matter of fact:

"Thus 'private' Companies were sanctioned by the highest legal authority in this country and it was 'only natural' that the Companies Act, 1907, regulated them expressly [6])";

and PALMER is satisfied with remarking that

"It was quite time—with this rapid multiplication of 'private' Companies going on—that a more precise meaning should be attached to the term..." [7])."

Without underestimating the pressure of the "tide" of "private" Companies steadily growing in number, other much more basic factors, in our submission,

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[1]) *Law Quarterly Review*, vol. 26, p. 11.

[2]) "Allgemeine Elektrizitätsgesellschaft Berlin"; L.R. VON SALIS, *Schweizerisches Bundesrecht*, Bern 1903, Band IV, No. 1630.

[3]) Kaisers Kaffeegesellschaft G.m.b.H.; compare GOELDLIN DE TIEFENAU, "*L'Introduction de la Société à Responsabilité limitée en Suisse*", p. 15.

[4]) Compare e. g. DICEY's *Conflict of Laws*, p. 126 et seq.; GRAVESON, *Conflict of Laws*, p. 80, 81.

[5]) Companies Act, 1907 (7 Edw. 7 c. 50).

[6]) *Law Quarterly Review*, vol. 62, p. 385.

[7]) PALMER, *Company Precedents*, p. 717.

must have persuaded the Legislator to recognize the "private" Companies in the Act of 1907. Parliamentary Reports and other parliamentary papers provide some indications.

1. Sect. 10 of the Act of 1900 [1]) for the first time divided Joint Stock Companies into two classes: those which did issue a prospectus and those which did not [2]). Yet, this distinction was by no means introduced in order to legalize the existence of the "private" Companies. On the contrary, it was devised because the same Sect. 10 was to render the issue of prospectuses more difficult through more stringent rules and an extensive liability of promoters and directors [3]). The process of formation, which meant until then a mere formality without real information, was now to compel the promoters to make effective disclosures and to increase their responsibility. This was unbearable for the small "private" incorporate company which, if it was to be maintained, was necessarily to be excepted from the increasingly severe provisions concerning the prospectus. Thus the "prospectusless" companies—as they were called at that time [4])—were the statutory ancestors of the modern Private Companies.

The Act of 1900 had some unfortunate consequences. Thus, in the opinion of some, the decrease in the number of companies and in the amount of total invested capital which occurred in the first lustrum of the century was partly caused by the very rules of Sect. 10 of the Act which made "many prudent and honest men decline to take the risk of accepting directorship...[5])".

1896: *4291* companies registered; £ 285 261 077 nom. cap.; £ 66,47 on each share
1905: *3967* companies registered; £ 108 655 043 nom. cap.; £ 27,38 on each share.

It is noteworthy that the number of *small companies* (under £ 20 000) however, which, as the Report continues [6]), are "frequently private concerns and obtain their capital by personal negociation and in many cases are merely the conversion of family concerns into companies without fresh capital being introduced", did not follow the current, but on the contrary *increased* a little:

1900: *2757* companies registered
1905: *2833* companies registered

A further consequence of the requirement of information set out in Sect. 10 of the Act of 1900 was that companies, in order to evade the provision, *simply did not issue a prospectus*, "but offered the shares on the Stock Exchange and sold

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[1]) Companies Act, 1900 (63 & 64 Vict. c. 48).
[2]) Compare e. g. the Earl of Granard's statement in the House of Lords (HANSARD 171, col. 165/166).
[3]) Compare e. g. *Report of the Company Law Amendment Committee,* 1906, Cmd. 3052, p. 5, No. 16 (3).
[4]) Appendix to *Report of the Amendment Committee,* 1906, p. 11.
[5]) *Report of the Company Law Amendment Committee,* 1906, Cmd. 3052, p. 5, No. 16 (3).
[6]) Figures taken from the *Report of the Company Law Amendment Committee, supra.*

them to the public there" [1]), without any information on the circumstances of the company being available for the purchasers of the shares. Such practice became quite common and the number of companies which did not offer shares to the public increased therefore rapidly to the detriment of the regular "public" companies which had to issue a prospectus. In 1901 (first year of operation of the Act of 1900) out of

3132 companies registered in London,
2485 *filed a declaration that they did not go to the public*,

and only

647 did not file such declaration, which is 20% of the total registered.

In 1904 the figures were:

3477 registrations,
3068 *declarations not to apply to the public*,

and

409 did not file the declaration, which is 11% of the total registered.

Thus a decrease from 20% to 11% is to be noted and the proportion is even worse, if we consider that only 250 out of these 409 companies applied at the end of the process of formation for a certificate to commence business [2]). It was also reported [3]) that within a short time after registration, the names of the shareholders *could be counted by hundreds* in numerous cases of companies which pretended not to invite the public for subscription.

Hence the attempt in the Act of 1900 to distinguish and to define the type of company which had to be released from the severe provisions on formation had been a failure and it was in 1907 the Legislator's special concern to find remedies for this unsatisfactory state of affairs, where shares could always before long find their way into the hands of the public.

2. The committee in charge of elaborating reform proposals suggested in its Report [4]) that all companies not issuing a prospectus should be compelled to file a *preliminary statement* containing the same information as would have been contained in a prospectus [5]), had one been issued. Moreover, every company incorporated under the Act was to be compelled to *publish its accounts*. This meant a further series of safeguarding provisions rendering still heavier the liability

[1]) HANSARD, 171 col., 165, House of Lords; or compare *Report of the Company Law Amendment Committee*, 1906, *supra*, p. 6, No. 17: "The modus operandi is to take a large block of the shares, credited as paid-up as the consideration for the sale of one's property to the company; then proceed to dispose of the shares or of the greater part of them in the Stock markets or privately, the result being that a large body of shareholders are introduced into the company".

[2]) Figures taken from the *Appendix to the Report of the Amendment Committee, supra*, Memorandum of the Registrar of Joint Stock Companies, p. 93/94.

[3]) *Supra*.

[4]) *Report of the Company Law Amendment Committee, supra*, No. 45, p. 17.

[5]) According to subs. (c)–(m), Sect. 10 of the Act of 1900: mutatis mutandis.

and more difficult the formation and carrying on of companies. Was the so-called "private" Company to be exempted from the operation of these provisions?

The Amendment Committee was perfectly aware of the increasing proportion of companies under the Act classed as "private" Companies. The number of their members, it is reported [1]), "usually does not exceed 20 and is very commonly not over seven; the regulations of the company usually restrict more or less the right to *transfer* the shares; the capital is subscribed privately but ceases to be private when appeal to public is made. A large number are formed for purposed co-operation or as 'conversions' of existing businesses into companies". The Committee came however to the conclusion—notwithstanding many statements and memoranda expressing opinions to the contrary—that there were *not sufficient reasons* for exempting the "private" Companies from the preliminary statement and from the filing of the balance sheet [2]), having regard to the need for the protection of the creditors which was to be decisive. This was a typical reaction against the fraudulent formations which had occurred since the Act of 1900.

The Amendment Committee did perhaps not completely overlook the effect of such a recommendation, but, being aware of the likelihood of dissentient opinion in Parliament, it wisely recommended that if any distinction was to be made, a *real definition of the private company* would be needed [3]). For this contingency the Committee proposed that a "private" company should have no more than 30 members [4]) on formation and that the number of members should not increase over 30; this was the remedy against the large concerns which had abused the form of prospectusless companies in order to circumvent the issue of a prospectus. Furthermore, the transfer of shares should be restricted, and invitation to the public to subscribe should be prohibited.

Subsequently, it was in fact agreed in Parliament that the Committee's proposals—refusing to the "private" companies any advantages not conferred upon the other companies—would mean the clear suppression of that type of company. But the association as a "private" company was a *reality* and it had to be taken into consideration if disturbances in the commercial structure in which it now played an important part were to be avoided.

Since it could not be made subject to the increasingly severe provisions for big businesses, a status of its own was to be established for the "private" company. Hence, the Bill adopted the Committee's proposed definition, and this was subsequently adopted in Parliament. As to the duty of companies to *publish accounts* the new Private Company escaped that burden owing to an amendment in the House of Commons [5]).

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[1]) *Report of the Company Law Amendment Committee 1906, supra,* No. 45, p. 17.
[2]) *Ibid.,* No. 46, p. 17.
[3]) *Report of the Company Law Amendment Committee,* 1906, *supra,* No. 51.
[4]) In the Law of 1907: a maximum of 50 members.
[5]) Hansard 181, col. 1534.

Now the *technical* distinction between public and private companies was achieved [1]). Thus, to the criterion of the invitation to the public which had proved insufficient and unsatisfactory were added differentiations in the number of members and private character of the business which were held to correspond best to the type of small concern described.

A brief account of the history of the provision on the minimum number of members required may be appended. It was proposed that the number of members should be reduced to *two*, in order to legalize the circumstances created by the decision of the House of Lords in the *Salomon Case* [2]) entitling say *two* persons who wish to form a limited company to hold practically all the capital and enabling them to retain control, subject to the services of five dummies to be engaged and given five non-participating shares. The Amendment Committee which was in point of principle opposed to the statutory recognition of Private Companies found that the requirement of seven members was in practice neither onerous nor inconvenient [3]). The controversy was not yet settled in Parliament. At last however, in spite of the argument that seven members were required to assure the bona fides of the company, it was agreed that *two members were to be sufficient* [4]).

The Private Company obtained its statutory recognition in Sect. 37 of the Companies Act, 1907 [5]) which is the "definition section". The special provisions and privileges are dealt with fragmentarily in the various Sections applying to Public Companies.

3. *Comparative remarks.*—The analysis of the development of the private company type until 1907 should have demonstrated that the English and the Continental, particularly the Swiss approach, are entirely different from each other.

Once the necessity or only the desirability of the creation of an intermediate type of corporation was recognized, the Swiss Legislator (and with him several other Continental legal systems) was to a certain extent free to choose the shape of its new creation, to devise a system of rules in the manner above described,

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[1]) Compare HANSARD 171, col. 166, House of Lords.

[2]) Compare e. g. *Report of the Company Law Amendment Committee,* 1906, *supra,* p. 32; a very accurate remark of psychological character is to be noted: "Thus at the outset those forming the company are taught that they cannot get round the requirements of the Law; they acquire a contempt for it which is apt to lead to more serious breaches of its other provisions." (Note by Mr. Worthington Evans).

[3]) *Report of the Company Law Amendment Committee 1906, supra,* No. 48.

[4]) HANSARD 181, col. 903/904 (Commons): "If the minimum were to remain at 7, all that would be necessary would be to get five clerks to take a merely nominal interest in the concern" (per Mr. Lloyd George, President of the Board of Trade, as he then was).

[5]) (7 Edw. 7, c. 50); Sect. 28 of the Companies Act 1948 (11 & 12 Geo. 6, c. 38); compare FORMOY, *The historical foundations of Modern Company Law,* p. 141.

It appears from what is expounded in the present § 2 that the statement in the new Swiss Commentary (W. VON STEIGER, "*Kommentar zum schweizerischen ZGB*", Bd. 5, "Die G. m. b. H.", at p. 7) which says that the Private Company was introduced ("eingeführt") by the Act of 1862, is bound to create some misunderstanding.

and to fuse the collected elements together into the new mould which was believed to be appropriate to the commercial needs of the country. One typical example of such careful combination and assessment of interests is the rather elaborate system of liability as devised in Art. 802 of the Swiss C.O.

On the contrary, the English Legislator found himself before a company form which had already been shaped by the commercial world. When the provisions of the Acts of 1900 and 1907 were made more stringent, thus rendering unsuitable the ground upon which the "private" Companies had grown, the alternative for the Legislator was either to grant them adequate exemptions or to ignore their existence with the consequence of jeopardizing the equilibrium of commercial organization.

As we have seen, it was decided to leave the private companies their historical basis and the task was therefore concentrated on *devising the limits* corresponding best to the *existing* type of "private" Company which was to be privileged. There was not any question of creating a new type or even of influencing the nature of the historical "private" Company by any legal complexities. Moreover, in contradistinction to Continental solutions, the whole *system of liability* as established for Joint Stock Companies in general was to be applied *without any discrimination*, since the "private" Company had worked satisfactorily under the then existing provisions regarding liability. With his great ability to grasp the essentials of a problem on a purely practical level, the English Legislator took only the minimum measures necessary to keep the machinery running, whereby little room was left to theoretical considerations and legislative elegance in which continental lawyers indulge sometimes with varied success. The development of the "private" Company is a typical example of the English methods of Legislation.

To use the proper expression, the S. à R. l. was *introduced* into the Code, whereas the Private Company received a statutory *recognition* [1]). The different origins and developments appear again in that terminological difference.

As regards legal policy it is to be remarked that, as in the circumstances described in German Law, a gap had been caused by the increasing severity of the provisions of the Acts. Both the introduction of the G.m.b.H. in 1892 and the recognition of the Private Company in 1907 followed closely such development of the "Public" Company type.

Finally it should be mentioned that in the opinion of the continental lawyer the historical development of Private Companies is surprisingly closely connected with the *prohibition of an invitation to the public*, the foremost criterion upon which Public and Private Companies were distinguished from each other. At present, the Act does expressly prohibit any invitation to the public to subscribe for any

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[1]) "La Compagnie privée anglaise est une création de la pratique, régularisée *ex post facto* par le législateur" (compare Pic et Baratin, "*Des Sociétés à Responsabilité limitée*", p. 78).

shares or debentures of the company [1]), and the Courts' opinion upon what need not be considered as an invitation to the "public" is most limitative [2]).

On the contrary, although the case might not be very frequent in practice, the promoters are free, according to Swiss Law for instance, to offer the shares by means of circular letters or prospectuses addressed to persons beyond their domestic concern [3]).

§ 3. THE PRIVATE COMPANIES SINCE THE COMPANIES ACT, 1907

1. As a consequence of the Act a great movement started towards incorporation of businesses which had previously been carried on as Sole Traders or as Partnerships. A certain number of transfers from Public Companies to the Private Company type, the requirement of which were found more adequate in the given circumstances, could also be noted. Contemporary observers called it a "rush" towards "conversion".[4]). A glance at the statistics shows that they did not exaggerate:

	1908	*1909*	*1910*	*1911*
Total number of Private Companies in the Register on December 31st	19 190	24 999	28 602	34 565
Number of Companies registered as Private Companies in the year ending on December 31st. . .	3 018	4 982	5 419	5 194 [5])

During the five years preceding the first World War an average of more than 6000 new companies were registered every year, and during a boom which followed the end of the war, the number of new registrations reached 10 085, 9581 of which were Private Companies [6]).

Even war time conditions (in both World Wars) implying restrictions on economic expansion did not alter appreciably the rate of increase of Private Companies; at any rate their popularity was not hampered [7]).

2. Although the Act of 1929 brought no change in point of principle [8]) in the provisions which concerned the meaning and privileges of Private Companies, some suggestions had been made before the Greene Committee aiming at the "re-assimilation" of the standards of Private Companies to those of Public Companies, at least with regard to the filing of accounts [9]). Notwithstanding certain evident abuses this Committee was able to find in its Report that the great

[1]) Sect. 28 subs. I(a) of the Act.
[2]) Compare e.g. Re *South of England Natural Gas Co.*, [1911] 1 Ch. 573.
[3]) JANGGEN-BECKER, *Commentary*, Art. 779, N. 4.
[4]) Compare e.g. *Law Quarterly Review*, vol. 26, p. 14 (1910).
[5]) Figures taken from the 18th, 20th, 22nd *Annual Report on Companies by the Board of Trade.*
[6]) JORDAN, *Private Companies*, p. 12.
[7]) Compare *The Solicitor*, vol. 12, p. 157; *Solicitor's Journal*, vol. 89, p. 514.
[8]) A slight modification in Sect. 26 (6) of the Companies Act, 1929 (19 & 20, Geo. 5, c. 23) is to be noted.
[9]) *Minutes of Evidence* taken before the Wilfrid Greene Committee 1925/26, 23rd day, No. 5025, 24th day, No. 5343, Appendix DD, p. LXXIX.

majority of Private Companies were conducted honestly, and rejected therefore the suggestion that Private Companies should be compelled to file accounts [1]).

This was but a prelude to the subsequent important controversy on the same matter which ended after arguments varying from support of the "status quo" to proposals for radical suppression! -with the dividing of Private Companies into two different types defined in the Act of 1948 as *exempt* and *non exempt* Private Companies. Except for the *exempt* Private Companies which have to comply with the conditions set out in Sect. 129, subs. (2) of the Act, Private Companies are now compelled to file accounts according to the rules applicable to Public Companies.

3. The merits of this new settlement of the problem of Private Companies are discussed elsewhere [2]). The historical aspect of the matter, however, still calls for some comment.

The dichotomy of exempt and non exempt Private Companies is but a further attempt to distinguish the "real" Private Company -as it grew independently in English commercial circles—from the larger concerns to be subsumed under the provisions of the Act relating to Public Companies. To the first unsatisfactory criterion affecting the prospectus were added—as we have seen -rules relating to the number of members and the limitation of transfers (in the Act, 1907) as remedies against abuses by large concerns which are taking advantage of a privilege not intended for them. It was indeed difficult to foresee at that time whether the exemption of Private Companies from the obligation of filing accounts (as newly imposed on Public Companies by the same Act) would in practice be applicable satisfactorily to the same range of privileged small concerns as defined in Sect. 26 of the Act, 1907. Experience has shown that with regard to undesirable practices which expanded rapidly, for example in connection with holding and subsidiary companies and also with the issue of loan capital, an additional and narrower line had to be drawn for Private Companies which wanted to continue to enjoy in particular the exemption from filing accounts. This was all the more necessary as the standard of disclosure in the Act of 1929 which has been described in professional circles as having shown "little specific appreciation of the importance of a fair disclosure of the profit or losses of the year" [3]) was to be put on a much higher level in the Act of 1948.

Here again it becomes apparent that the requirements of the "public" and the "private" Company type differ greatly: the more difficult the requirements for the Public Company are made, the less suitable they are for the Private Company. If the statutory sanction once given to Private Companies was not to become a dead letter, truly "private" business needed to be exempted from that irksome burden.

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[1]) *Report of the Company Law Amendment Committee* 1925/26 (London 1926) Cmd. 2657, No. 86, p. 45.

[2]) Compare § 9, III–IV.

[3]) *The Accountant*, vol. CXXI (1948), No. 3909, p. 540.

We cannot yet appreciate the merits of this recent, subtle and intricate distinction according to the criterion of publicity of accounts. Whereas the small trader and other businesses with identical needs seem to have found in the exempt Private Company the appropriate mould, the non exempt Private Company's position—now in many respects so close to the Public Company—is likely to be the object of reconsideration by the legislator before long [1]).

Thus the succession of attempts to establish an appropriate distinction between Public and Private Companies is not yet concluded, and there seems to be at least some truth in Mr. Justice BUCKLEY's opinion given before the Select Committee in 1898 [2]), more than fifty years ago, "that no satisfactory dividing line can be drawn between Private and Public Companies".

SECOND CHAPTER

ECONOMIC POSITION IN COMMERCIAL AND INDUSTRIAL LIFE

There is no exaggeration in saying that English Private Companies are a matter of national interest. They represent a very important factor in the industrial, commercial and social life of Great Britain.

According to the last available Report of the Board of Trade [3]), on register on December 1st, 1950, were *235 357 Private Companies*, of which 140 658 (59,7%) were Exempt Private Companies, and *15 999 Public Companies*.

In Switzerland, on the contrary, the number of S. à R. l.s, although increasing regularly, is still extremely small as compared with other forms of corporation and the Sociétés Anonymes in particular. The total number of S. à R. l. on the register in 1950 was *1358* with a nominal capital of 39 709 thousand Swiss Francs, the number of S. A., *20 326* with a nominal capital of 8 575 000 thousand Swiss Francs.

Our intention is to give first an account of some of the main uses of Private Companies seen from the angle of their specific advantages and privileges with a view to demonstrating their wide scope.

In the second place, the results of a 15 years' experience in Swiss Law will be outlined and as far as possible criticized in some points in the light of the English conception and achievement (§ 5). A selection of statistical figures follows in § 6.

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[1]) Compare e.g. "the future position of Joint Stock Enterprise" in *The Solicitor*, vol. 14, p. 42.
[2]) *Minutes of Evidence* taken before the Select Committee on the Companies Bill, 2nd May 1898, No. 1088.
[3]) Issued on 4th September 1951, p. 8.

§ 4. THE POSITION OF PRIVATE COMPANIES

I. The "comprehensive scope" of Private Companies

"No business is too small nor is any too large to be converted into a Private Company" [1]), according to English Law. No minimum or maximum amount of capital is fixed in the Statute Book. The frame offered by the Law is thus practically illimited and the Private Company can be used by any firm of ever so modest means.

Swiss Law, on the contrary, has set out a minimum capital of 20 000 Swiss Francs [2]), 50 % of which has to be paid up on formation, in order to guarantee the financial stability of the company.

A great number of Private Companies are incorporated with a small capital – £ 1000, or much less, is very frequent—whereas a Swiss business with the corresponding amount of capital could not take advantage of corporate status and limited liability. Thus, the "comprehensive scope" [3]) of the Private Company is to be underlined. It explains one important cause of the Private Company's much wider use.

II. Motives for selecting the Private Company as corporation form

The advantage of corporate status and of limited liability usually go hand in hand, although it has been frequently repeated that the form of Private Company is not so much chosen in order to obtain the benefit of limited liability, as to obtain *corporate status*. This is true in a number of cases, especially where private partnerships, in case the number of members increases beyond 20 [4]), are compelled to be incorporated under the Companies Act according to Sect. 434 and are therefore converted into Private *unlimited* Companies. But for the many thousands of industrial and commercial concerns for which the formation of a company is therefore obligatory, not more than about one thousand have been registered between 1921 and 1938 as *unlimited* Private Companies [5]). Our inclination is therefore to think that the limitation of liability, although not always vital for carrying on business, is in many cases a most welcome advantage, and it may in certain circumstances be of predominant importance. We are thinking, for instance, of the persons appointed as executors who are compelled to carry on a partnership business as active partners, and are thus personally liable [6]). Their next step is

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[1]) JORDAN, *Private Companies*, p. 24.

[2]) Corresponding in 1952 to approximatively £ 1000 (purchasing power); the average exchange rate of Sw. Fr. 12.30 for £ 1 does not reflect the real purchasing power.

[3]) JORDAN, *op. cit.*, p. 24.

[4]) In case of banking concerns, over 10 (Sect. 429 of the Act, 1948).

[5]) Apparently however with a fairly substantial capital. (*Minutes of Evidence* taken before the Cohen Committee, 7th day, N. 3088).

[6]) See however e.g. SNELL's *Principles of Equity*, pp. 249–251, as to the authority of personal representatives to carry on business and as to their liability.

evidently to convert the undertaking into a limited liability company in order to get rid of a possibly heavy liability [1]). It also affords to families and to friends of comparatively limited number with a smaller amount of money the advantage of being associated in business without rendering liable with their whole fortune the persons who do not intend to take an active part in the conduct of the business. The same considerations of limiting the risks must be valid for businesses of a hazardous character or for persons who contemplate establishing a new business with the help of a few others having special knowledge of the business and prepared to invest a small amount in the undertaking [2]). Apart from trading, a good deal of *research work* is carried on through Private Companies: three or four persons join together to do research and they form a small company with a capital of say £ 1000. A lot of research can be done with that amount and, if the results are not satisfactory, it is easy to stop and to wind up with a minimum of trouble.

Usually, however, as we have pointed out, both the elements of corporate status and of limited liability are considered by persons who avail themselves of the advantages afforded by Private Companies. The most current and wide-spread example is the *family business* which has been converted into a Private Company as being an ideal medium for it. First of all both the difficulties of entering into an elaborate partnership deed and the disadvantages incurred as a partner (unlimited joint liability and dissolution of the partnership in case of death or bankruptcy of a member) [3]), are thus avoided. No less important is the possibility of ensuring continuity of the structure and management of the family business and of providing for the respective interests of the persons engaged. The classical illustration is that of the owner of a business who desires for his sons or some other relative to take an active part in its management. The business usually is sold to the new company as consideration for the allotment of fully paid up shares to the vendor who presents the sons or other relatives with one share each, or, as in the famous and much contested *Salomon Case* [4]), the company may validly grant *debentures* to the vendor in part payment of the undertaking.

It should be noted incidentally that, if a present has been made of shares to family members more than three years before the owner's death, the amount of the death duty payable is reduced. Moreover, if the owner has converted his business into a company, he may, after his death, expect his executors' gratitude for thus facilitating the distribution of his estate instead of their being compelled to sell it to strangers possibly at a considerable loss.

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[1]) Compare *Minutes of Evidence, supra,* 9th day, No. 4243.

[2]) "Starting a new venture", JORDAN, *op. cit.,* p. 22.

[3]) Many cases occur where the financial resources of the survivors have been severly strained owing to the obligation imposed upon them to pay out the interest of their late associate (JORDAN, *op. cit.,* p. 23). The problem is the same in Swiss Law.

[4]) *Salomon* v. *Salomon & Co., Ltd.,* [1897] A.C. 22: "Not a fair representative of the Private Companies" says E. MANSON still in 1910 in *Law Quarterly Review,* p. 12, vol. 26.

Mention should also be made of some rather frequent cases, when conversion into a Private Company is made in order to obtain additional capital or only for the purpose of *raising a loan.*

Thanks to the possibility of forming Private Companies, a welcome tendency to accept directorships can be observed. Formerly most men kept to their own business and many prospective undertakings never had a chance of starting [1]).

III. Disclosure of accounts and limited liability

An experienced lawyer, when examined as a witness by the Cohen Committee on the most valuable advantage afforded by Private Companies, said that, if according to some proposals for reform, the Private Companies were to retain corporate status but should either file accounts or accept unlimited liability, they would certainly "select the lesser evil: file accounts" [2]). The privilege of secrecy of accounts which the *exempt* Private Companies still enjoy nowadays is nevertheless a major one in many respects. So much so, that for a considerable number of Private Companies, especially for small trading companies (retail shopkeepers) in the provincial towns of Great Britain, the alternative would not be disclosure of accounts, but liquidation and subsequent reversion to the partnership business with unlimited liability [3]).

Furthermore, as a general consideration, it is easy to realise that secrecy of accounts suits the private family business and it is just the advantageous possibility of combining corporate status and limited liability without losing the private character of business which affords to Private Companies such popularity in the spheres described.

Finally it should be mentioned that part of the activities of a Public Company are often carried on through the medium of one or more Private Companies either for convenience of administration, or for facilitating the payment of foreign taxation, and generally in order to avoid legal difficulties abroad. Since the 1948 Act all subsidiary companies (public or private) are treated uniformly as regards the disclosure of accounts [4]) and the provisions relating to the balance sheets and accounts have been consolidated. The tendency of some Public Companies to trade through subsidiary Private Companies in order to deprive the public of information is therefore no longer operative.

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[1]) *Minutes of Evidence, supra,* 15th day, No. 7873.

[2]) *Minutes of Evidence, supra,* 9th day, No. 4247, per H. Oppenheimer.

[3]) "It would not matter so much in London whether a person's accounts were disclosed, but one can well imagine that the butcher and the baker and the candlestick maker of the small town does not want his accounts and profits disclosed to his neighbour" (*Minutes of Evidence, supra,* 9th day, No. 4374).

[4]) Sect. 129 I (2) (A) (c) of the Act.

§ 5. THE POSITION OF THE SOCIÉTÉ À RESPONSABILITÉ LIMITÉE

I. Significance of the S.à R.l.

1. The legislative purposes of Swiss Law as regards the legal form and the characteristic enterprise for which it was shaped, has been pointed out briefly in connection with our historical considerations [1]).

Some details should be added to give a more concrete account of some further specific features of the S. à R. l. which, in the mind of the legislator, are to provide for some advantages denied by other forms of company:

a) Stockholding and management are linked together, since the members are jointly entitled and jointly bound to manage and represent the company (Art. 811 C.O.);

b) The members may be bound by the articles of association of the company to make *supplementary payments or prestations* (Art. 777 Ch. 2, 772, 803; "versements supplémentaires, Nachschusspflicht"), which, however, may only be required for covering losses.

The articles of association may also provide for *further prestations* (Art. 777 Ch. 2; "Nebenleistungen, autres prestations"). The possibility of imposing such prestations—which for cartels, for instance, may be even more important than the payment of capital—has the advantage of uniting incorporation with free regulation of the duties connected with membership [2]).

Both possibilities are unconceivable in the case of a "société anonyme" where the liability of the shareholder is strictly limited to the payment of his shares;

c) The *voting rights* and the participation in the profits may be freely regulated by the articles of association (Art. 808 al. 4, 804). Corresponding provisions of the "société anonyme" are less adaptable and, for the "société coopérative", not adaptable at all to various needs of the company (Art. 885).

d) Furthermore, the articles of association may provide for the right of the members to *leave* the company (Art. 822 al. 1); the members are also entitled by the law to request from the court the *right to leave the company for justified reasons* (Art. 822 al. 2) and—also for justified reasons—to request *the exclusion of a member* as far as the majority of the other members and of capital agree (Art. 822 al. 3).

2. This form of company which, in theory, seems to be highly adaptable to the various needs of the commercial world, does not appear to be adopted on a large scale by business circles. A rather convincing account of this assertion is given in a recent study on the subject [3]). We have to direct briefly our attention to its main conclusions.

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[1]) Compare § 1.

[2]) As for the various obligations, such as delivery and buying of goods, abstaining from certain activities etc., cf. v. STEIGER, *op. cit.*, art. 772 Nr. 31.

[3]) HONAUER, "*Die wirtschaftliche Bedeutung der Gesellschaft mit beschränkter Haftung in der Schweiz*" (1951); compare also the *statistical tables, infra,* § 6.

Upon recognition of the fact that the Law relating to the S. A. has remained—as we have seen elsewhere [1])—comparatively liberal, not excluding the possibility of association for individuals with interests other than sheer investment and loose or even inexistent personal bonds, the position of the S. à R. l. in its given shape is problematic, since it really does not afford in most cases more privileges than the S. A. does. In other words, the medium and the small sized enterprise with personal character are not hampered appreciably on formation and when carrying on business as a Société Anonyme. The only decisive point, the study continues, consists in the sum available for constituting the capital of the company. Thus the S. à R. l. is confined to be used where not more than 20 000 Swiss Francs can be raised [2]). The figures show that in most cases, when the minimum sum of 50 000 Francs is available (or even only 20 000 Francs which have to be paid up on formation of the S. A.), the "rival" form, the Société Anonyme, is chosen. Neither the necessity of three instead of two shareholders, nor the more rigid internal structure of the S. A. (a good part of the provisions of which can be waived by unanimous agreement between the members) are a sufficient obstacle to refrain the propensity of the business world to select it. The S. A. being suitable for medium and even partly small sized enterprise, there is no hesitation to expect from those who are able to clear the obstacle of the minimum amount of capital required by the Law. Even the provisions as regards liability are providing for a more definite situation, since every shareholder knows that he is released from any liability as soon as his shares are fully paid up, whereas the member of the S. à R. l. may be held responsible to the extent provided in Art. 802 C. O. Furthermore, and this consideration is not a minor one for the continentally trained mind, the carrying on of business in the form of the S. A. is regarded—rightly or wrongly—as a token of a high standard of probity.

2. The general conclusion is, as it appears in the aforesaid study, that the still hardly favourable reception of the S. à R. l. in Switzerland does not follow from structural shortcomings in its own characteristic features, but in the very conception of the Société Anonyme in Swiss Law: when the S. à R. l. was introduced into Corporation Law, the S. A. was not reshaped by the Legislator as thoroughly as would have been imperative in order to exclude from using the S. A. those enterprises for which the new form of company was especially intended.

It would seem premature to draw definitive conclusions on the mere ground of the above mentioned study. More time should elapse and further studies should be made on the subject, in order to establish if there are other determinant factors which are withholding the S. à R. l. from development, or if some new factors might—at length—favour the reception of this type of company.

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[1]) Compare § 1, p. 8.

[2]) Honauer, *op. cit.*, p. 94: "Die Frage GmbH oder AG ist in der Schweiz lediglich eine Frage des Kapitals."

II. Comparative remarks

What are now, if we consider the English experience, the remarks which can be added to these conclusions.

1. From the point of view of legal policy some interesting parallels can be drawn. Thus the problem of the S. à R. l. in the "shade" of the Société Anonyme shows some similarity with the difficulty of establishing the dividing line between Private and Public Companies, and particularly between the latter and the *non exempt* Private Company. As we have pointed out in connection with our historical survey [1]), it may be surmised that the Private non exempt Company created by the Act of 1948 has been placed into a rather precarious position since it is now deprived of the important privilege of secrecy of accounts. In our submission however, when the choice is to be made, there is much to be said yet for the selection of the Private Company on account of several formal requirements, especially on formation, which still remain much easier than in the case of a Public Company.

In Swiss Law, on the contrary, in such circumstances (mutatis mutandis), there is no advantage to be gained by selecting the S. à R. l. instead of the S. A.

Abeyance has been predicted to Private *non exempt* Companies and it may be that the future legislation will precipitate such a development. Yet, a corporation form for small business (the Private *exempt* Company) and the Public Company for large concerns would both remain available and keep the position they have acquired in English business life.

The Swiss legislative problem might turn out to be somewhat different. Thus a reform in Swiss Companies' Law should be extended beyond the S. à R. l. itself. We agree with the conception [2]) that the scope of the Société Anonyme should be restricted to the large enterprise in which investment is decidedly separated from management (as practised e.g. in English and German Law). The S. à R. l. would then regain its significance without any need for change in its own structure [3]).

2. This last assertion, however, calls for some comment. In fixing a minimum capital barrier of 20 000 francs, the small sized enterprises with very small sums of capital available have been excluded from the privilege of limited liability and legal personality. This is one of the basic differences of conception: a S. à R. l. with the "comprehensive scope" of the English Private Company would be considered as a potential instrument of mischief or fraud. The idea is so strongly established in Swiss Law that the relaxation of the S. à R. l. provisions would count very few advocates. The strict consequence of it would be that the legislator's hope to increase the popularity of the S. à R. l. might be crushed for the obvious reason that the above mentioned solution, recommending a shift in the

[1]) Compare § 1.
[2]) Honauer, *op. cit.*, pp. 92, 101.
[3]) Honauer, *op. cit.*, p. 101.

Law of the *Société Anonyme only*, would merely *compel* a certain number of companies—no longer adaptable to more severe provisions—to convert into a S. à R. l. For the enterprises with smaller means, however, that is for the kind of S. à R. l.s registered with the minimum capital sum of 20 000 francs, representing nowadays 70 % [1]) of all S. à R. l.s, there will be *no new incentive* and thus hardly any appreciable increase in number. Whether the conversions from S.A. into S. à R. l. would be numerous cannot be foreseen; they would however not contribute very much to a wider reception of the S. à R. l.

§ 6. STATISTICAL TABLES

The following figures have been taken from the General Annual Report on Companies by the Board of Trade and from the "Annuaire statistique de la Suisse" published by the "Bureau fédéral de Statistiques".

They have been reproduced and partly arranged with the sole intention to give a general idea of the numerical aspect of the main conclusions outlined in the preceding paragraphs.

We are purposely abstaining from the attempt to draw comparative conclusions which would necessitate, in our submission, a thorough and cautious analysis of a list of most diversified factors to which the figures stated in the tables are subject. This would be beyond the scope of our work.

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1) Figures taken from HONAUER, *op. cit.*, p. 80. Further 25 % between 20 000 and 50 000 francs.

Great Britain: Companies having a share capital on the registers Table I

Private Companies			Public Companies	
Number	Paid-up Capital in Million Pounds	Year	Number	Paid-up Capital in Million Pounds
95 598	1590	1930	16 263	3893
122 679	1706	1935	14 695	3938
146 735	1923	1939	13 920	4117
149 814	1961	1940	13 742	4113
154 995	1948	1941	13 571	4105
159 186	1955	1942	13 433	4088
163 261	1946	1943	13 395	4078
169 205	1935	1944	13 303	4052
178 558	1929	1945	13 171	4044
200 743	1923	1946	13 172	4078
218 483	1971	1947	13 168	4110
225 519	2040	1948	12 873	3885
231 443	2040	1949	12 075	3854
235 307	2198	1950	11 920	3898

Switzerland: Sociétés à responsabilité limitée and Sociétés anonymes Table II

S. à R. l.			S. A.	
Number	Nominal Capital in Million Swiss Francs	Year	Number	Nominal Capital in Million Swiss Francs
—	—	1902	2 203	1801
—		1910	3 914	2963
—	—	1920	7 337	5209
—	—	1930	13 475	8708
60	1,901	1937	19 567	7662
216	6,030	1938	18 995	7312
308	8,858	1939	18 207	7048
370	10,413	1940	17 701	6857
443	12,450	1941	17 205	6842
550	16,005	1942	17 023	6892
665	19,019	1943	17 138	6983
746	21,285	1944	17 345	7049
875	24,868	1945	17 890	7119
1028	29,129	1946	18 801	7373
1181	33,454	1947	19 194	7846
1262	36,785	1948	19 526	8125
1316	38,495	1949	19 946	8254
1358	39,709	1950	20 326	8575

Great Britain: Registrations of companies having a share capital, classified according to the amount of their nominal capital

Table III

Registered in the year:	1925	1930	1935	1938	1939	1941	1943	1945	1946	1947	1948	1949	1950
All companies	7931	8301	13 000	12 501	10 466	6892	6447	10 193	23 815	20 508	15 458	13 638	13 123
Share capital:													
Under £ 1000*.	1690	2763	4 619	5 046	4 336	2676	2178	2 833	6 400	5 336	4 274	4 048	4 139
£ 1 000 and under £ 5 000*	3397	3408	5 414	5 104	4 342	3158	3048	4 928	11 646	9 503	7 180	6 106	5 561
£ 5 000 » » £ 10 000	1140	893	1 183	1 132	849	659	694	1 337	2 990	2 806	2 062	1 732	1 683
£ 10 000 » » £ 20 000	749	626	834	640	540	275	399	757	1 741	1 731	1 209	1 063	1 085
£ 20 000 » » £ 50 000	482	352	481	37	258	80	76	222	660	708	464	469	451
£ 50 000 » » £ 100 000	195	109	169	100	78	20	28	62	235	253	165	137	130
£ 100 000 » » £ 200 000	140	77	158	67	33	16	14	40	85	95	45	50	38
£ 200 000 » » £ 300 000	49	40	67	17	16	2	3	3	20	27	16	16	21
£ 300 000 » » £ 400 000	33	10	25	8	1	—	3	1	7	14	7	3	4
£ 400 000 » » £ 500 000	16	2	8	2	1	—	—	4	7	5	6	1	2
£ 500 000 » » £ 750 000	20	9	21	9	5	4	4	3	16	18	14	4	5
£ 750 000 » » £ 1 000 000	5	2	7	2	—	—	—	—	1	1	10	1	1
£ 1 000 000 and above	15	10	14	4	7	2	—	3	7	11	6	8	3
** representing, in % of the total:*													
Under £ 1000	21	33	35	40	40	39	34	27	26	25	28	29	31
£ 1000 and under £ 5000	43	41	41	41	41	46	47	48	48	46	46	45	43
Total	64	74	76	81	81	85	81	75	74	71	74	74	74

Position of the S.à R.l. among other forms of corporation available

(on the Register at the end of the year)

Table IV

Year	Raison sociale individuelle	Sociétés en nom collectif et en commandite	Sociétés coopératives	Sociétés anonymes	Sociétés à Responsabilité limitée
1930	54 265	9 997	11 677	19 639	
1937	54 499	9 999	11 686	20 173	68
1938	54 299	9 927	11 657	19 599	218
1939	54 176	9 909	11 593	18 816	309
1940	54 301	9 833	11 560	18 287	383
1941	54 671	9 934	11 530	17 753	463
1942	55 675	10 002	11 518	17 471	565
1943	56 710	10 143	11 621	17 512	680
1944	57 993	10 353	11 798	17 697	771
1945	59 713	10 831	12 031	18 243	890
1946	62 245	11 798	13 301	19 203	1047
1947	64 337	12 411	12 275	19 814	1201
1948	66 545	12 890	12 247	20 379	1286
1949	68 424	13 120	12 225	20 740	1349
1950	70 728	13 281	12 256	21 303	1398

Industrial and commercial position of the S.à R.l.

Table V

Year	Industry	Trade	Loan Societies	Hotel Trade	Communications + Transport	Building Societies	Other Societies	Total
1937	28	28	—	2	1	6	3	68
1938	82	87	5	5	5	23	9	216
1939	121	114	9	3	11	36	14	308
1940	148	137	9	4	16	42	14	370
1941	188	159	8	6	17	47	18	443
1942	239	193	8	9	22	56	23	550
1943	292	240	9	11	25	64	24	665
1944	320	262	8	12	36	83	25	746
1945	371	318	8	14	46	91	27	875
1946	441	385	6	15	46	105	30	1028
1947	490	460	7	18	52	123	31	1181
1948	515	505	7	17	58	127	33	1262
1949	532	532	7	18	55	139	33	1316
1950	533	560	11	18	56	147	33	1358

SPECIAL PART

THIRD CHAPTER

THE PROVISIONS ON PUBLICITY

§ 7. PUBLICITY REQUIREMENTS ON FORMATION

I. The process of formation in Swiss Law

According to Swiss Law, Art. 779 C.O., the *act of foundation* of a S. à R. l. consists in the completion of a deed "passé en la forme authentique" [1]), in which each founder has to declare his willingness to found the company and give his assent to the "statuts". The deed which is to be signed by each founder has furthermore to contain the confirmation

i) that all the "parts sociales" have been subscribed;

ii) that the prescribed amount (minimum according to the Law or a higher amount by special provision of the "statuts") has been paid up in money or in "kind", all together being at the unrestricted disposal of the company;

iii) that the contracts as to allotment for a consideration other than in cash have been duly produced. The official ("l'officier public qui a dressé l'acte") has to declare that all the documents serving as voucher for these confirmations have been duly submitted to him and the founders.

The final step of the process of formation is the registration with the "Registre du Commerce". It is introduced by an elaborate formal application (Art. 780 C.O.) in written form with i) the signatures "dûment légalisées" of the members and the managers; ii) the amount of the "part sociale" and the amount paid up thereof; iii) the mode of representation; iv) an attested copy of the "statuts" and the authenticated act of foundation which must both be attached to the application. After the examination of the application and of the documents by the Registrar, the registration is effected according to Art. 781 C.O. which enumerates all details to be stated in the "Registre du Commerce". Finally the contents of that statement are to be either partly or fully *published in an official periodical* ("Feuille officielle du Commerce"). Such kind of publication is unknown in English Law, but is to be found in several continental systems of Law [2]). The company receives its legal personality through the registration. It is now able to begin business.

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[1]) A solemn act involving the parties and an "official" (usually a notary).

[2]) Art. 930, 931 C.O., Art. 9, 113 "Ordonnance sur le Registre du Commerce", Art. 781 C.O.; France: Art. 13 de la Loi de 1925, modifié par décret-loi du 30 oct. 1935; Germany: Art. 10 of the Law of 1892; Belgium: Art. 6 of the Law of 1935.

This long list of formalities is *in every way similar* to those laid down for the "simultaneous" [1]) foundation of the Société Anonyme (Art. 638, 639, 640, 641 C.O.). It undoubtedly was not easy to find the appropriate set of rules shielding the company against corrupt practices without rendering the apparatus of protection so cumbersome as to deter businessmen from using the proposed form of association. Thus, considering that the S. à R. l. was intended for enterprises smaller than the Société Anonyme, it was established that a S. à R. l. could already be formed with only *two members* (Art. 775/1 as against Art. 625 C.O.). Some relief has also been granted since the Art. 633/3 C.O. does not apply to S. à R. l.: the payments need not be effected to an authorized depositary [2]). The choice of the place of deposit is left to the founders, subject to the Registrar's consent [3]). On the whole, however, the Legislator has not simplified for the S. à R. l. the modalities of formation [4]) required for the setting up of the Société Anonyme (Art. 638 et seq. C.O.). The similarity of rules in the Société Anonyme and the S. à R. l. has been demonstrated above.

The reasons for the maintenance of a comparatively expensive process with solemn forms and various control provisions is to be found here again in the leading principle of protection of the creditor. A less dogmatic reason presumably is also that the warning example given by the notoriety of abuses in German Law strongly influenced the Legislator in setting up rules aiming at both the establishment of the company on solid ground and the security of investments: the Swiss S. à R. l. was not to be the "more comfortable" form, as the German G.m.b.H. has sometimes been called.

II. The process of formation in English Law

Turning to English Law, we have to note beforehand that a *public company* which does not invite the public to subscribe for shares and therefore does not issue a prospectus on its formation, nevertheless has to file with the Registrar before allotment a *statement in lieu of prospectus* (Sect. 48 of the Act, 1948).

The promoters of a *Private Company* [5]) however are *released from the duty* of filing such a statement in lieu of prospectus (Sect. 48, subs. 3). Assuming that the process applying in the case of companies making no invitation to the public corresponds to the "simultaneous" formation as known in Swiss Law, we can easily recognize an important difference between both legal systems. Whereas Swiss Law, as we have seen, applies to the S. à R. l. the detailed formal provisos enacted for the "simultaneous" formation of the "Société Anonyme",

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[1]) The "successive" formation is inconceivable.

[2]) "Office de consignation désigné par le Canton."

[3]) It should therefore, in practice, be at least some reliable bank or similar institution (cf. JANGGEN-BECKER, *Commentary*, Art. 774, N. 13).

[4]) As against French Law, for example.

[5]) Any invitation to the public for subscription is prohibited when a Private Company is concerned (Sect. 28 I c.).

English Law, when a Private Company is concerned, drops the important formal requirement of a statement according to Sect. 48 [1]).

Publicity and preliminary conditions in the formation of Private Companies therefore are particularly simplified [2]).

The Private Company is formed simply by lodging with the Registrar a memorandum and articles of association (Sect. 12) [3]) and paying the requisite fees. Moreover, as soon as the certificate of incorporation is issued, the company is able to commence business at once, since neither the restriction on commencement of business (Sect. 109 1 (2) and subs. 7), nor the requirement of a trading certificate apply (Sect. 109 (3); 109 subs. 7 (a)) [4]).

§ 8. FURTHER PUBLICITY PROVISIONS

Beside the rules concerning the formalities on the formation of the company, several other provisions regulate the nature and extent of the *information* about the company's business, which are considered to be of concern for the creditors as well as for the members of the company themselves.

I. The registers

We shall deal first with the "*registre des participants*" (Art. 790 C.O.) which is a register containing a list of the members, the value of the "parts sociales" and the part paid-up thereof by the members, statements as to transfer of "parts sociales" and any other modification. This register should always be brought up to date and, as it is open to all members, it is intended to offer an internal protection. Whereas this register is reserved to the members, publicity with regard to the creditors is secured by a *list* drawn up by the managers with the contents corresponding to that of the "registre"; it is to be filed with the Registrar at the beginning of every year [5]). Since alterations may occur in the

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[1]) The importance of this privilege can be gauged from the suggestion to reintroduce the requirement of delivery of a statement in lieu of prospectus, which has been made before the Cohen Committee in connection with the reform of publicity in Private Companies (per Sir Arthur Stiebel, *Minutes of Evidence* taken before the Company Law Amendment Committee, "Cohen Committee"), (Companies Act, 1929), 4th day, p. 119.

[2]) "It is almost unbelievably easy and even more unbelievably cheap to form a company in this country" remarks Prof. Kahn-Freund in a critical article in the matter (*Modern Law Review*, vol. 7, p. 57).

[3]) Together with a declaration of compliance with the Act, Sect. 15, subs. 2.

[4]) "With a Company Agent to provide prints of Memorandum and Articles of Association, two clerks to sign declaring themselves desirous of being formed into a company and agreeing to take one share each, a stenographer (named in the Articles as the first secretary of the company) making a statutory declaration that the requirements of the Law have been complied with, and a sum of £ 5 for duties and fees, one has all that is necessary. When these documents have been lodged with the Registrar of Companies he must give his certificate that the Company is incorporated"... (*Minutes of Evidence, supra,* Memorandum submitted by the Registrar of Companies for England, at p. 12).

[5]) Subject to an annual statement that no change intervened (Art. 790/2 C.O.).

meantime, the creditors are entitled to inquire about such alterations at the office of the company.

The corresponding institution in English Law is the *Register of Members* (Sect. 110) which contains in the main the same information as the "registre des participants" [1]). This register is kept at the office of the company and is to be open to inspection by *any member and by any other person.*

The register of members is only the first in importance of a set of registers which have to be kept by the company, such as a Register of Directors and Secretaries (Sect. 200), also accessible to the public; a Register of Directors' shareholding (Sect. 195) open only to members and debenture holders; a Register of Debenture Holders (Sect. 86) open to inspection of shareholders, debenture holders and others; a Register of Charges (debentures) (Sect. 95), together with Registration of the charges with the Registrar; a Register of Mortgages (Sect. 45) open to any interested person.

II. The annual return

An institution similar to the "lists" to be filed with the "Registre du Commerce" and recapitulating the contents of the "registre des participants" is to be found in the *return* every company with a share capital—therefore also the Private Company—has to make at least once a year. A copy of this annual return must be forwarded to the Registrar (Sect. 124 and Part I of the 6th Schedule) and has to contain a list of members, debenture holders, directors and secretaries, a summary of shares issued, calls paid etc.... (according to the various registers).

§ 9. PUBLICITY OF ACCOUNTS

I. In Swiss Law

Publicity of accounts was a contested question in Switzerland in the twenties when an amendment to the C.O.[2]) introduced for all Sociétés Anonymes (Public Company type) having a nominal capital of 1 million Swiss Francs (and over), the duty of publication of accounts and balance sheet in the "Feuille officielle du Commerce". As in the case of the banks which must publish their accounts according to Swiss Legislation [3]), the main consideration was that large enterprises are a matter of public importance. They should therefore provide due information about their financial position. With the revision of the Code of

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[1]) Names and addresses of the members, a statement of the shares held by each member, distinguishing each share by its number, so long as it has one, and the amount paid or agreed to be considered as paid on the shares of each member; the date at which each person was entered in the register as a member, the date at which any person ceased to be member.

[2]) "A.C.F. du 8 juin 1919, Art. IX."

[3]) "Loi sur les Banques, Art. 6, al. 4–5; art. 24, Ordonnance d'Exécution."

Obligations in 1936 however, the provision of the amendment of 1919, which appeared to be unsatisfactory, was dropped. There is no longer any obligation for any kind of Société Anonyme to publish its accounts since then [1]).

In the Swiss S. à R. l. Law which was enacted at about the same time, *no publication of accounts is prescribed* either. The leading opinion is that small concerns for which the S. à R. l. form is intended should neither be encumbered with such a comparatively expensive and intricate duty, nor should they have to apprehend the competition of large enterprises thus enabled to obtain valuable information about their smaller rivals' accounts [2]). Moreover, in pratice, prospective creditors are always entitled to ask for disclosure of accounts before they decide to deal with the company. There is only a duty of *internal* publication enacted in Art. 696 C.O. Accordingly, accounts and balance sheets are to be kept in the company's office at the disposal of the members at least 10 days before the annual meeting and for one year's time afterwards.

II. In English Law. Initial development

We hardly exaggerate the importance of the problem of publicity of accounts in asserting that it is a crucial one in English Company Law. When the new Act of 1948 was drafted, the choice between publicity and secrecy of accounts decided not only the future basic features of the Private Company, but determined also the whole equilibrium of the available forms of association in English Law, since the suppression of the Private Company was seriously considered at that time by distinguished experts in company matters [3]). The position of Private Companies in English Law and some aspects of the important problem of disclosure of accounts have been discussed in the general part (§ 2–4). The main facts of the development are briefly repeated here.

The Companies Act, 1907, provided the obligation for Public Companies to deliver to the Registrar a balance sheet, but *exempted* Private Companies (which then obtained their first statutory recognition) [4]) *from that requirement*. No change intervened until the Act of 1948, when the privilege of secrecy of accounts enjoyed by all Private Companies was restricted, broadly speaking, to small sized companies, the shares of which are beneficially owned and controlled by the registered holders and in which no shareholder is a company (Sect. 129 subs. 2, so-called Private "exempt" Companies).

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[1]) See however Art. 704 C.O. which enables under certain safeguards creditors to examine unpublished accounts; this Art. 704 is the unique remainder of numerous publicity proposals which were the object of a long controversy between both Houses of the Swiss Parliament. Compare A. Muheim, "*Die Publizitätspflichten der Aktiengesellschaften und Banken im allgemeinen*", pp. 59–64.

[2]) Compare A. Muheim, *supra*, pp. 43–64; E. Müller, "*Der Gläubigerschutz in der G.m.b.H.*", p. 44.

[3]) Compare p. 31, footnote [4]).

[4]) Compare § 2, II.

III. Publicity of accounts and the 1948 reform

We shall now analyse in some detail the principles and trends which influenced the above-mentioned historical development in its last phase, that is in the period preceding the Act of 1948. We believe that it sums up, at least for a good part, the problem of Private Companies as it appears in English Law.

Apart from the fact that public interests are at stake in larger enterprises, there is one classical rule of English Company Law which made unquestioned the obligation for *Public* Companies to file their balance sheets with an official board: *Publicity of accounts is a corollary of the privilege of limited liability*. This is a kind of "do ut des" which should enable any prospective creditor to satisfy himself that the securities, now limited to the company's assets, are not encumbered with debts which may eventually jeopardize the security of his claim [1]).

Although the rule mentioned should be applicable to *Private* Companies inasmuch as they enjoy the same privilege of limited liability, the argument of the Cohen Report [2]) was that if publicity of accounts cannot be required from partnerships and individuals it is not to be requested from companies either.

The Legislator's opinion also was that secrecy of accounts nevertheless was needed, since this new form of corporation was especially intended for small-scale (family-) businesses which should not be overburdened by expensive and cumbersome requirements as imposed on Public Companies. Moreover, the balance sheet would not be unduly disclosed to competitors.

Now, practice has demonstrated that more than $^{9}/_{10}$ of the companies limited by shares are Private Companies [3]). Furthermore, rather numerous Public Companies were trading as holding companies by means of various subsidiary companies (acquired or formed for the purpose), the accounts of which could be kept secret. The *public control over companies was therefore practically almost suppressed.* Apart from that, abuses of the freedom of Private Companies in general were rather frequent [4]).

Hence, as already pointed out, a reform was introduced with the Act of 1948. How delicate a problem the Legislator had to solve, is shown in the Cohen Committee Report and in the Minutes of Evidence before the same Committee. Arguments defending the status quo are mainly based on considerations we have already mentioned. A frequent and important remark is that disclosure of accounts would cast upon the small family company the danger of being exposed to the inspection of more powerful concerns, whereas the small business would not

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[1]) "The companies are getting extra privileges in some ways, and they ought to give at least as much information", per Sir ARTHUR STIEBEL, *Minutes of Evidence, supra,* 4th day, No. 1185.

[2]) Report of the Committee on Company Law Amendment (1945), Cmd. 6659, "*Cohen Report*", p. 27, No. 51.

[3]) 134 882 Private Companies and 15 872 Public Companies according to the General Annual Report on Companies by the Board of Trade for 1947 (before the new Companies Act).

[4]) "Private Companies are used as the repositories and distributing points of money obtained from the public by fraud" (*Minutes of Evidence, supra,* p. 44).

gain corresponding advantages from information about the finances of the large [1]). And, on the level of international trade, it might induce competitors from abroad to have the affairs say of a subsidiary company exhibited, which might, if it carried on business abroad, be endangered by discriminatory legislation or additional taxation on the facts disclosed in the accounts [2]). These subsidiary companies at least should be exempted.

Furthermore it is apprehended that too many regulations about statutory accounts and other details might seriously hinder the small scale enterprise from forming a Private Company [3]).

Much emphasis is also laid upon the assertion that the privilege of exemption is the "most tempting feature" of this form of association, limited liability being a very minor consideration; "once this privilege gone, there is no point in Private Companies at all", says STIEBEL [4]). Such prediction was of course to be particularly considered with regard to the *great number* of companies which had been or were still being registered as or converted into Private Companies, a fact which proved that the privilege granted by the Act of 1908 to Private Companies conferred most valuable advantages on the business community.

On the other hand, in the opinion of some, all Private Companies also should be compelled to lay open their accounts. The creditors should be given the fullest information practicable, thus enabling them to estimate the creditworthiness of the enterprise. Moreover, the problem of subsidiary companies would be solved as soon as Private Companies had to file their accounts [5]).

Another argument supporting the same view was of somewhat political colouring: the trade unions should be given the possibility of gleaning information to assess the justice of wage rates offered by employers [6]).

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[1]) "The larger and more diversified the business of a company, the less useful to a competitor is the information which he can derive from a perusal of its accounts, even if other things are equal." But other things are not equal, because whatever the small company could learn from the accounts of its larger rival, the large concern may be able to drive the small out of business, but the latter can do little harm to the former. (*Cohen Report, supra,* p. 27, No. 51); compare also *Solicitor's Journal,* vol. 89, p. 515.

[2]) *Minutes of Evidence, supra,* 11th day, No. 3314; 13th day, No. 6365.

[3]) See for instance, *Minutes of Evidence, supra,* 4th day, No. 1215. The justification by the fact that Private Companies do *not apply to public* for raising capital is also brought forward. (Prof. KAHN-FREUND, *Modern Law Review,* vol. 7, p. 58.)

[4]) *Minutes of Evidence, supra,* 4th day, No. 1029. "The remaining privileges would not be worth the institution; Private Companies should then be removed." Compare also Prof. KAHN-FREUND, article in *Modern Law R view,* vol. 7, p. 59.

See however: "The privilege of secrecy of accounts, unless the Law required much more detailed accounts, hardly can matter so much, since the *laxity of account rules* of Company Law made it possible to set up a balance sheet so as to keep it practically *uninformative!*" (*Solicitor's Journal,* vol. 89, p. 515). This argumentation lost soon its actuality, since detailed stringent provisions as to the standards of accounts were devised at the same time and sanctioned afterwards by the Act of 1948. But it gives a good example of some abusive developments of too widely framed rules. (Compare e. g. *The Accountant,* vol. CXXI, No. 3909, p. 540).

[5]) See for instance *Minutes of Evidence, supra,* 5th day, p. 77, No. 1517/19, per Mr. ARTHUR WITHWORTH and Prof. GOODHART.

[6]) *Cohen Report, supra,* p. 26; *The Solicitor,* vol. 12, p. 147; *Solicitor's Journal,* vol. 89, p. 515.

On the whole, however, the advocates of disclosure have perhaps been most disarmed by those who agreed that information is desirable, but found that the creditors have *other means* of obtaining it. Even if the account provisions were to be made more stringent in the new Act, they would not be available in time to be of some help to the creditors [1]). Much more efficient and common than scrutinizing accounts, they pointed out, is the consultation of trade enquiry agents or of the bank, before deciding to grant credit. Somewhat questionable is however the argument that nobody need give credit to or do business with a Private Company until he has made full enquiries, and received fullest disclosure [2]); in our submission it assumes that the rule of "supply and demand" is regularly working to the creditor's or trader's advantage, whereas this does not seem to be always the case, especially not in small trading circles. For the banks, however, it is true that they are in the usual position to refuse the grant of loan, overdraft or other facilities, if the accounts of the company have not been duly disclosed to them [3]). "No accounts, no advance!" [4]). If the bank however is not satisfied, the directors may be requested to guarantee the account *personally*. The far-reaching effect of this last security measure which is of extreme importance as far as the Private Company's credit is concerned is discussed elsewhere [5]).

We have only reproduced a few of the numerous opinions on the basis of which the Cohen Committee had to devise its recommendation. Whilst maintaining the principle of exemption as a leading rule, the Cohen Committee proposed to restrict this privilege to these companies for which it was primarily intended, namely the small privately-owned (family-) businesses. Thus, although the need for effective protection of creditors through proper information had been repeatedly stressed [6]), it was eventually agreed that the family enterprise should be nevertheless exempted. This being established, the difficult and delicate task of devising a workable legal definition for "the small family business incorporated as a company" still was to be accomplished [7]). This has been done in a very ingenious way. The definition is now enacted in Sect. 129, subs. 2 and the 7th Schedule [8]). A company is to be considered as a *Private exempt Company* on condition that

i) none of the shares or debentures are held by a company;

ii) none but the holder (except a bank, holding the shares as security for a loan, or trustees of a deceased member's will, etc. [compare 7th Schedule]), has any kind of interest in any of the shares or debentures;

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[1]) Compare e.g. *Minutes of Evidence, supra,* 13th day, No. 6862.

[2]) Appendix NN to the *Minutes of Evidence, supra,* 20th day, p. 595; Appendix P to the *Minutes of Evidence, supra,* p. 211.

[3]) Appendix T to the *Minutes of Evidence, supra,* p. 246 (Memorandum by the Committee of London Clearing Bankers).

[4]) *Minutes of Evidence, supra,* 9th day, No. 4379.

[5]) See p. 77 et seq., p. 79–80.

[6]) Compare e.g. *Minutes of Evidence, supra,* 5th day, No. 1568 et seq., 1617, 1618.

[7]) *Cohen Report, supra,* p. 27, No. 53.

[8]) As to the new definition from the historical standpoint, compare § 3.

iii) no more than 50 persons are holding debentures of the company;

iv) no body corporate is director of the company and there is no control of the policy of the company by any person except the directors, members and debenture holders (or trustees for debenture holders).

IV. Exempt and non exempt Private Companies

The solution described has not been welcomed everywhere. Thus it has been remarked that the maintenance of the privilege of limited liability and secrecy of accounts would prejudice Partnerships and Single Traders who have to compete with Private Companies and who cannot benefit from both privileges at the same time [1]). In fact, however, the new type of Private "exempt" Company having been introduced only a few years ago, it is still difficult to appreciate properly the advantages and shortcomings of the solution.

Of the 235 357 Private Companies on the registers in Great Britain on December 31st, 1950, 140 652 (59,7%) have filed with their annual returns the certificate under Sect. 129 (1) b to obtain the *benefit of the exemption* [2]) [5]). The importance in English Company Law of the Private "exempt" Company can be gauged from these figures and it seems that this revised and newly defined type of company will answer the needs of the community and respect the so-called "dignified reticence" [3]) towards a disclosure to the *general public* [4]), although it may be interested; but it appears at least in reputable concerns that the unwritten rule has emerged from a natural balance of interests, which entitles any prospective shareholder and anybody who intends to give credit to receive any reasonable information. This kind of "corrective" outside the Statute Book, on one hand, renders less opaque the veil covering dealings of some Private Companies, but on the other hand leaves them the freedom they really need [5]).

Hardship has certainly been done to smaller concerns which are unable to comply with the declaration of Sect. 129 and are therefore *non exempt* Companies; but that was unavoidable [6]). The position of *Private non exempt* Companies, which

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[1]) See e.g. Prof. KAHN-FREUND in *Modern Law Review*, vol. 9, p. 242, who calls the novelty of the Report "one of the least satisfactory features of it".

[2]) *General Annual Report on Companies by the Board of Trade for 1950*, p. 6 and table V (latest available).

[3]) *Minutes of Evidence, supra*, 8th day, No. 3576, per Mr. GRANVILLE TYSER, director of Lazard Broth. & Co.

[4]) However, it would be exaggerated, in our submission, to say that the new Act has left the "privacy of Private Companies' business unchallenged", as *The Economist* had predicted (27th March, 1948, vol. CLIV 5457, p. 513).

[5]) It is doubtful whether the directors will be able to obtain sufficient information on ownership and interest in shares (compare *Solicitors' Journal*, vol. 92, p. 614).

[6]) An unexpected result of the new distinction has been that many Private Companies, now compelled to file accounts, have restricted the fuller information previously given in their profits and loss accounts (e.g. details as to turnover and cost of sales) to that which is essential according to the Act. The result is that the shareholders are sometimes receiving accounts less informative in this respect than those prior to the Act of 1948 (*The Accountant*, "15 months experience" vol. CXXI, pp. 539, 556).

now differ practically only on few points from the Public Companies, is rather questionable; but a certain time must elapse until the argument that such type of company is worthless [1]) proves its own value.

§ 10. CONCLUSION

I. As regards the formalities of foundation we remark that Swiss Law has particularly insisted upon the creditor's protection without special regard to the need for an easy and supple way of setting up the S. à R. l. Thus, in contradistinction to French Law [2]) for instance, the general trends on the whole have not been followed in that respect. It is interesting to note that this attitude has been adopted though the available measures securing liability seem to provide already a sufficiently high degree of protection for the creditor.

English Law, on the contrary, has been extremely liberal, reducing the formalities to a minimum [3]). This advantage, together with the privilege of secrecy of accounts [4]), has been an important reason for the rapid and general reception of that type of corporation in England.

II. Concerning the registers to be kept by the company, the needs appear to be identical in both systems of Law. In the Act the rules for the Public Company apply and thus are taken over with all their detailed provisions. However, the smaller the business concerned, the more some of the manifold registers may lose part of their practical importance.

It may be added that in Swiss Law, any transfer of "shares" is valid only when it is entered in the "registre des participants", which thus is not only an instrument of internal protection, but also has legal effects from the standpoint of substantive Law [5]) (Art. 791 C.O.).

III. With the exception of the period from 1919 to 1936 when it was found necessary to impose upon large enterprises of the type of the Société Anonyme *the publication of the company's accounts*, no special importance seems to have been attached to the problem in Switzerland, particularly not in the case of S. à R. l's of modest dimensions. It has been accepted, although with some controversy [6]), that it is necessary to safeguard secrecy of accounts for the Société Anonyme

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[1]) Compare § 3, pp. 12–13.

[2]) In the Law of 1925; control by "commissaires" is provided for the Sociétés Anonymes, which does not apply to S. à R. l's.

[3]) "... a very competent clerk is able to do the work inside 24 hours! For a *Public Company* it takes a fortnight and there is a lot of money to pay and a tremendous amount of work... the complications are very much greater..." (*Minutes of Evidence, supra,* 9th day, No. 4352).

[4]) The limitation of liability as a privilege does not seem to have been so decisive for the development of the Private Company (Appendix K to the *Minutes of Evidence, supra,* 6th day, p. 134); (Memorandum by the Institute of Industrial Administration).

[5]) In England, similarly, a transfer is incomplete until registered, subject to an equitable right of the transferee to have the shares transferred (PALMER, *Company Law,* p. 110).

[6]) Compare A. MUHEIM, *op. cit.,* pp. 55–64, as regards the Société Anonyme.

and a fortiori for the S. à R. l. since the latter is a company form [1]) destined for medium and small sized enterprises, where disproportionate expenses, intricacy of rules and the danger of being exposed to competition from larger rival businesses would be avoided. It is a commonplace for the continental conception [2]) that the public ("die Allgemeinheit") has no interest in the financial results of the S. à R. l. and consequently no right to obtain information thereon. The creditors at any rate may require from the directors to lay open the accounts when dealing with them: if the company is interested in concluding the bargain, it will not refuse the disclosure.

There is no lack of advocates of such a liberal attitude in England either. Statements like

"the affairs of the Private Company are of no concern to the public and if a Private Company wishes to borrow money from a bank or private person, it is for that bank or private person to assure themselves of the affairs of the company... The requirements of filing accounts is giving to the general public information to which they are not in the least entitled [3])",

are exactly in the line of thought of HACHENBURG [4]), and have been made here and there by experts for instance before the Cohen Committee. But precisely that learned Committee—the recommendations of which have been subsequently followed in Parliament—did not fail to consider that kind of opinion as an "Early Victorian point of view" [5]), thus documenting without ambiguity its own conception.

In requiring of the Public Companies that they file their accounts, it had been recognized in England that this sort of measure represents an *additional protection* for the creditors, since information can be more easily obtained through the official sources and since the companies are compelled to set out their accounts at least according to minimum requirements.

Now, the exemption enacted for the benefit of Private Companies is based on the consideration of the *company's size, purpose, and relationship towards other trading concerns*, and indeed *not* on the conception that the public need not receive the described information. English Law has in that respect been aware of the basic difference between the interests of investors and the interests of traders. Whereas it is true that the public at large (investment market) has no interest in Private Companies because it is not asked to buy shares, the trader who deals in goods with the company in everyday life needs as much information

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[1]) Attention was also paid to *research* and *development* enterprises which often have only very scanty resources at their disposal. Increased protection of creditors would have a *restrictive effect* on the initiative of the directors (compare e.g. Appendix K to the *Minutes of Evidence, supra,* p. 136).

[2]) "Die Allgemeinheit hat kein Interesse an den Ergebnissen der G.m.b.H.; sie hat daher auch kein Recht, sie zu erfahren" (HACHENBURG, "*Kommentar zu der G.m.b.H.*", § 41, Anm. 34).

[3]) *Minutes of Evidence, supra,* 5th day, p. 79, No. 1568 et seq., No. 1615.

[4]) Compare *supra,* footnote [3]).

[5]) *Minutes of Evidence, supra,* 5th day, p. 79.

as possible. This aspect of the problem does not seem to have been considered thoroughly in Continental Law [1]).

As we have seen, the reason for granting the privilege of secrecy of accounts to Private Companies was not connected with the assumed desinterestedness of the public as it has been elsewhere, e.g. in Swiss Law. Considering therefore the real motives as already described, it is easier to understand that the introduction of a new type, the Private "exempt" Company, meant nothing else than a selection and a definition of the Private Company which in fact complied with the requirements of dimension, purpose, etc., and to which the privilege of secrecy of accounts was still to be vouchsafed for the aforesaid reasons.

The fact that the non exempt Private Company—although it does not apply to the public—now has to file its accounts with the Registrar as a Public Company, does perfectly square with the general line of thought of the English Legislator; but it *would not* be the case on the Continent.

We may conclude by saying that Swiss and English conceptions on publicity of accounts are founded on appreciably *different standpoints*, although the *result is the same* for both systems when the S. à R. l. is compared with the "exempt" Private Company. The difference of conception externally only appears when the "non exempt" company is concerned.

IV. We have based our whole analysis on the current assumption [2]) that one basic difference between the Société Anonyme and the S. à R. l. type is the *restriction* of publicity requirements. It has however been shown that this is only a very broad rule which does not apply in all cases and does not express the various degrees of restriction in theory and in practice.

"The present Company Law falls short of a desirable standard of publicity", said Prof. KAHN-FREUND before the Act of 1948 [3]). Whereas the requirements for the formation of a company remain as easy as before the new Company Law, the rules as to publicity of accounts are now, from the standpoint of the continental systems, extremely well balanced and adapted to the development of Company Law.

FOURTH CHAPTER

THE RAISING OF CAPITAL

Except for a number of general questions mainly on minimum capital and payment in cash (Part 1), we shall be especially concerned with one aspect of raising capital: the payment for shares for a consideration other than in cash (Part 2).

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[1]) See e.g. E. MÜLLER, *op. cit.*, p. 44.

[2]) Compare e.g. "*Rechtsvergleichendes Handwörterbuch*", p. 721, 757; DE SOLA, "*Tratado de Sociedades de Responsabilidad limitada*", p. 33.

[3]) *Modern Law Review*, vol. 7, p. 59.

GENERAL REMARKS

I. According to Continental tradition the material provisions as to the raising of capital are cautiously devised in Swiss Law: a minimum capital of 20 000 Swiss Francs, of which a minimum of 50% must be paid up (at least 10 000 Swiss Francs) in cash or in kind is compulsorily required (Art. 773, 774/2 C.O.). A substantial *guarantee* thus is not only given to the creditors and to the company which has now a capital at its disposal to start business, but a hasty and unconsidered participation is avoided, since the prospective member has to pay "on the nail" at once. The Federal Court held moreover that each founder has to pay his 50% himself [1]). The limitation to a maximum of 2 millions Swiss Francs which is intended to exclude large concerns from using this form of company, has no function of guarantee.

II. As compared with the provisions described, English Law affords several surprises to the Continental lawyer.

First he has to put up with the notion that *issued* capital is not usually the same as *authorized* capital. The directors issue only the capital they think necessary for the start and the difference up to the nominal capital may be issued subsequently according to the needs.

Furthermore, provisions as to minimum or maximum capital are unknown to English Company Law [2]). No objection can therefore be made against the formation of a company with a capital of £ 10 [3]), for instance.

The requirement in Sect. 47 (I) (3) establishing a minimum amount of 5% of the nominal amount of each share to be paid on application is waived in the case of Private Companies, there being no invitation to the public to subscribe for shares [4]).

III. Whereas the Continental conception is that the use of companies (with corporate status and limited liability) finds its justification only where "the realization of the proposed commercial task requires so much capital as can only be found by the collaboration of a number of individuals" [5]), English Company Law confers also its advantages upon firms with the smallest means, which otherwise would have to be carried on by individuals in their own name or in the form of a Partnership.

The introduction of some kind of guarantee on formation has however been

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[1]) *A.T.F.* 67 I 115.

[2]) Compare however p. 38, footnote [2]).

[3]) More startling examples of extreme cases in Jordan, *Private Companies;* thus registrations seem to have occured with £ 1 as capital devided into 960 shares each. In 1924 a Private Company was registered with a capital of one Halfpenny devided into two shares of one Farthing each. An initial capital of £ 5 seems to be current.

[4]) Different opinion in De Sola.

[5]) *Minutes of Evidence* taken before the Company Law Amendment Committee, Appendix R.R., p. 644 (Cohn).

discussed repeatedly by the English Legislator. Recently, before the Cohen Committee, for instance, proposals were made either to require of companies a minimum capital, or to provide for a deposit of say 10% of the capital on similar terms as required of insurance companies before the Assurance Companies Act, 1946 [1]); but these suggestions have been received with little enthusiasm, the general apprehension being that it would possibly tie up the money of the company in cases where it should be spent, and that it would be an unfair hardship in certain cases (such as in the case of Private Companies being formed on death of the owner or a principal partner of a business) to ask for a cash deposit or a minimum paid up capital [2]).

Thus, English Law is withstanding the Continental conception that an appropriate safeguard can be afforded to creditors by the means described. It may be of some interest for the foreign lawyer to note that, under the influence of contemporary Continental Law, requirements of a minimum capital (£ 20 000!), a minimum value of £ 25 for each share [3]), 3/4 subscription of the nominal capital and 1/5 to be paid up on each share prior to the registration were provided in the *Limited Liability Bill, 1855*. Restrictions were however soon introduced in both Houses, the minimum capital being fixed at £ 250 with at least 25 members, and the requirement of a minimum value for the shares being dropped. The life of the 1855 Act which contained these provisions was short. It was swept aside by liberal trends which ruled the following 1856 Act (no longer any minimum capital, subscription or paying up of subscribed shares) and do not seem to have lost their influence at any time of subsequent company legislation [4]).

PART 2

THE PAYMENT FOR SHARES FOR A CONSIDERATION OTHER THAN IN CASH

Shares are usually paid for *in cash*. On condition that this payment is effected in time, there is no difficulty. In the economic life however, the company which is to be formed often may not only need cash values, but also property (such as patents, goodwill, stock-in-trade, equipment, sometimes a whole trading concern) to be brought in.

If the prospective members are able to make over such property to the company, shares may be alloted to them on the ground that the whole or some part of the allotment shall be credited as paid up. The consideration for the

[1]) By the Assurance Companies Act, 1946 (9 & 10 Geo. 6, c. 28) a deposit is no longer required but a minimum paid up capital of £ 50 000 (PALMER, *supra*, p. 369).

[2]) *Minutes of Evidence, supra*, Appendix R. (1), p. 243; Appendix K., p. 134); 4th day, No. 1037, 1038. A minimum of £ 2000 (which about corresponds in value to the Swiss minimal amount) was considered as too high.

[3]) Compare Swiss Law, Art. 774 C.O.: minimum value of shares: 1000 Swiss Francs.

[4]) Historical considerations in *Law Quarterly Review*, vol. 62, p. 379.

allotment is "other than in cash" [1]). There is, of course, an equal economic need for the possibility of making over non-monetary property, when the future members of the company have no cash value at their disposal.

Now the hesitant way in which the various Legislators have dealt with the setting up of provisions for the issue of shares for a consideration "in kind" was not directed against the means of "apports en nature" themselves, but against the overvaluation of such assets.

The overvaluation does not result only from the exaggerated optimism prevailing among the founders at the time of formation of the company. Much more frequent are the abuses practised by unscrupulous elements who purposely exaggerate the value of the assets they intend to make over to the company. One could draw up an almost endless list of various frauds resorted to in the matter: a worn-out machine is valued as a brand-new one, imaginary goodwill is brought in, insignificant inventions are overpraised.

This problem is of great importance, since the allotment of shares for overvalued assets means the undermining of the company's capital in its function as guarantee fund.

§ 11. METHODS OF VALUATION

I. In Swiss Law

If the "part sociale" is paid up otherwise than in cash, the following particulars are to be stated in the "statuts":

a) the object and nature of the property to be made over;
b) the value of property;
c) the base of valuation;
d) the name of the member to whom the "part sociale" is to be allotted;
e) the amount of the "part sociale".

These are the provisions of Art. 778/1 of the Swiss C.O.[2]).

Beside the statement in the "statuts", the same particulars have to be delivered to the Registrar of the "Registre du Commerce" and then entered in the "Registre" and duly published in the "Feuille officielle du Commerce". (Art. 781, 930, 931 C.O.; 9, 113 "Ord. R. du C."). These provisions are compulsory; no member will be able to get a "part sociale" for a non monetary consideration,

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[1]) "Paid-up otherwise than cash" as the somewhat elliptical, but usual expression runs (see PALMER, *Precedents*, p. 21). "Apports en nature" (Swiss, French Law). "Sacheinlage" (German Law).

[2]) Art. 778 is based on the wording of the S.A.'s Art. 628 with which it is identical. So is in general the process of publication of non monetary payment and the consequences in case of default of publication. However, according to the nature of the S.A., Art. 628 is followed by several other publications of the same particulars, as in the report of the promoters (Art. 630, C.O.), in the prospectus (Art. 631/1 C.O.), and on the occasion of the first meeting (Art. 635, 638/3/4 C.O.).

unless the above mentioned requirements are satisfied [1]). The creditors are entitled to rely upon the "statuts" and on the details stated therein. Secret agreements are not valid. An agreement without these formal requirements, or an incomplete agreement, is not legally binding, but the member is not released from his duty of paying and, of course, of paying *in cash*. He may try eventually to recover his property according to the general principle of Art. 62 C.O.[2]). Furthermore the promoters, and in case of increase of capital, the board of directors, will be held liable for damage caused by default of publication or incorrect information (Art. 827 C.O.; the provisions of the S.A. for the valuation apply throughout, Art. 753 et seq. C.O.). The founders thus are obliged to act carefully and the creditors of the company together with the members joining after its setting up are given the opportunity of controlling the "apports" and their valuation. It is due to the detailed provisions relating to publication that the creditors will be able at least to recognize where overvaluations may have occurred and where caution is recommended. Identical possibilities of control and security are given to the creditors in German Law.

II. In English Law

English Company Law deals with the difficulty of valuation in a similar manner:

Sect. 52: "When however a company limited by shares... makes any allotment of its shares, the company shall within one month thereafter deliver to the Registrar of Companies for registration:

1) ...

2) in the case of shares allotted as fully or partly paid up otherwise than in cash,
   a) a *contract in writing* constituting the title of the allottee to such allotment;
   b) together with any *contract of sale* [3]), or for services or other consideration in respect of which that allotment was made... and a *return* stating the number and nominal amount of shares so allotted, the extent to which they are to be treated as paid up and the consideration for which they have been allotted."

In case of default, the directors are subject to penalties which are very onerous (£ 50 per day) and thus may have some preventive effect. Relief may be granted in the form of an extension by the Court of the time for delivery in certain cases [4]). The enforcement of the company's duty to file any returns regulated in Sect. 428 also applies to the return mentioned in Sect. 52. Accordingly any member or

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[1]) There is no special provision for this question. The general rule of Art. 11 C.O. applies (JANGGEN-BECKER, *Commentary,* Art. 778, N. 17).

[2]) Possibly: right of retention on the objects made over, until payment in cash is effected (JANGGEN-BECKER, *Commentary,* Art. 778, N. 17). The subsidiary liability for cash payment is generally recognized.

[3]) It is interesting to note that English Law, more cautious than Swiss Law, provides the delivering of the contracts of the "apports". This is not the case in Swiss Law and is sometimes deplored, as the Registrar's control is rendered both more difficult and less effective (JANGGEN-BECKER, *Commentary,* Art. 781, N. 1.

[4]) Sect. 52, subs. 3, al. 1 and 2; the act of the officer must have been done wilfully and knowingly. Sect. 440, subs. 2, according to the general rule.

creditor can apply to the Court for an order directing the company to make good the omission within a certain time. It should be kept in mind that the liability of the shareholders is not affected by the omission to register the contracts. Furthermore, as in Swiss Law, the omission does not make void the allotment [1]). These are in the Act the provisions likely to regulate and control the publications of the "apports" and thus to give to the prospective creditor the guarantee that the assets really represent the money value which the promoters claim they represent.

III. Comparative remarks

The question now, whether an independent authority should regularly be called in for the valuation of the assets made over to the company, has always been very much contested. As against the majority of legal systems, Italian Law introduced a compulsory legal process of estimation of the property made over (Art. 2476, "Codice civile", ref. to Art. 2342 and 2343, thus applying the provisions relating to the "Società Anonima"); it is true that an official control (e.g. by the Board of Trade) would be the appropriate method of increasing the control over the "apports"-agreements, but as the requirements of publication stand at present, the prospective creditor will not know how the valuation was effected, as no—or only incomplete—particulars have to be given in the matter. This is valid for the English as well as for the Swiss Law [2]). The only thing he will certainly be informed of, is the consideration for which a member of the company received a certain number of shares of a certain value.

But although France, for example, has its "Commissaires aux apports" for the S.A.[3]) and Germany certain control provisions as to "Gründungsrevision" and "Gründerbericht" for the A.G.[4]), no requirement of that kind is provided in these legal systems for the S. à R. l., and the G.m.b.H. respectively. The same may be said of Swiss Law (compare specific S.A. dispositions in Art. 630, 631, which do not apply to the S. à R. l.), and of English Private Company Law where more valuable information is given to the creditor in a series of provisions apply-

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[1]) In French Law the consequence of the omission of publication means the nullity of the company itself ("nullité relative", compare Art. 9 JANGGEN-BECKER, *Commentary,* Art. 778, N. 16). German Law: §§ 5 I, 8 II, 10 and 19; § 19: consequences of no publicity: the covenant as to non cash payment is void.

As to "allotment" according to Swiss Law, cf. pp. 39–40 and the references quoted at p. 40, footnote No. 1.

[2]) The mere reference to a balance-sheet seems to be sufficient for the latter (K. HUBER, "*Die qualifizierte Gründung der G.m.b.H.*", pp. 79, 80).

[3]) At the first meeting the subscribers for cash have to nominate the "Commissaires aux apports". Their task is to give expert opinion on the allotment of shares otherwise than for cash. When shares are offered to the public, they have to be selected from a list of experts with technical qualifications (architects, engineers...), (compare J. ESCARRA, *Cambridge Law Journal,* vol. 11, p. 22, for further details).

[4]) §§ 191, 192, 193, 202 HGB, compare HACHENBURG, "*Kommentar zur G.m.b.H.*", § 5, Anm. 12.

ing to Public Companies only (Sect. 38, 4th Schedule, part I, No. 14, 16). The reason for the aversion to official control is to be found in the fact that even an independent official authority is not infallible, in spite of experience and impartiality. Even more important is the economic argument that too detailed a publication as to the quality and value of assets may endanger the company's secrets, especially when small businesses—as Private Companies usually are—have to compete with huge concerns.

In the two legal systems with which we are concerned, the promoters are thus free to choose bases for the valuation of assets brought into the company on allotment of shares. As this valuation may be purely arbitrary, one is induced to ask if there is, beside the publication requirements, any other real guarantee given to the prospective creditor. A more detailed account of this problem follows.

§ 12. THE PROTECTION OF CREDITORS AGAINST OVERVALUATION (Redress Provisions)

I. Swiss and Continental Law

To counterbalance the privilege enjoyed by the business man as a result of limited liability, the Legislator of the Swiss S. à R. l. was particularly anxious to confer upon the creditors of the Company every possible protection. If the provisions as to publication and valuation do not entirely satisfy the creditor's needs for guarantee, it is because of the opinion that the centre of gravity of the system was first of all to be based on the question of liability for any default of the persons concerned and *not* on the question of a detailed system of valuation [1]). Prevention of overvaluation is of secondary consideration. Hence, the Swiss S. à R. l. Law established beside the publication provisions the joint and direct liability of the members for the real value of the property made over to the company. This results directly from Art. 802 C. O., the basic principle of liability in the S. à R. l.; in consequence of overvaluation, the nominal capital is not considered as having been fully paid up. There is no express provision in the Law about the application of Art. 802 to the situation under discussion; but it is generally agreed that it does apply [2]). The risk of possible overvaluation passes over to the company. The members, however, are released from their liability only when the "apports" really had the *published value* at the time of their transfer to the company. The burden of proof for this fact relies upon the members themselves [3]).

The regulations of French Law are similar; but whilst the liability in Art. 802 C. O. can be enforced only at the time of the winding-up, the French Legislator

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[1]) Fanconi, "*Die Haftung der Mitglieder einer G.m.b.H.*", p. 45.

[2]) See however Goeldlin de Tiefenau, "*L'Introduction de la S. à R. l. en Suisse*", p. 89, and excellent arguments for the nowadays valid opinion in Fanconi, *op. cit.*, p. 47.

[3]) Compare e.g. Fanconi, *op. cit.*, p. 49.

expressly provides in Art. 8 a claim with ten years' term of prescription from the date of the signature of the "contrat de société" on the ground of an immediate joint liability of the members for the real value of the property. French jurists have often questioned the utility of Art. 8, alleging for instance that it would be dangerous for prospective members to join a company with this sword of Damocles hanging over their heads. There may, of course, be grounds for such apprehension from the standpoint of the capitalist, whose particular purpose is the investment of his money with the utmost advantage [1]). The S. à R. l.— and the corresponding foreign corporations—however, usually are small companies with only few members and of a predominantly personal character. Relying upon mutual confidence, the members can be expected to accept more easily the liability of Art. 8. The same can be said of Art. 802 of the Swiss C.O.

The §§ 24, 31 of German Law deal with the guarantee provisions made necessary by the omission to introduce the control provided by the "Gründerprüfung" in case of the "Aktiengesellschaft". They establish the subsidiary joint liability ("Subsidiäre Deckungspflicht") of the members for outstanding payments and "Wiederbringung rechtswidrig ausgezahlter Gewinne". This provision has several weaknesses, the greatest being that "payment" is to be understood as *cash* payment. Hence it does *not* apply to payments for a non-monetary consideration (just where particular security is most required!) [2]). This is one main reason why discredit has been brought upon the German G.m.b.H.

The various systems we have been dealing with in this chapter and in the preceding one can be summarized in the following manner:

i) Official estimation and control (Italian Law);

ii) Publication of the agreements and other particulars, free method of valuation, but, as a counterbalance, strong joint liability of the members for undermining the company's guarantee capital trough overvaluation of assets (French law);

iii) Similar to ii), the liability, however, being enforced at the time of the winding-up of the company (Swiss law);

iv) Similar to iii), the liability of the members for the value of the assets applying however only to cash payments (German law).

II. English Law

Turning now to English Company Law, it is a most striking fact that there is no real protection given to the creditors against overvaluation of assets, since the described publication requirements, together with provided penalties, are not likely to hamper swindles effectively. The matter has been dealt with in quite a number of cases and the following rules have been established.

If a valid contract be made for the acceptance by the company for fully or partly paid up shares, for a consideration other than cash, the Court will *not*

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[1]) Pic et Baratin, "*Des Sociétés à Responsabilité limitée*", No. 176.

[2]) Hachenburg, "*Kommentar zum Gesetz betreffend die G.m.b.H.*", § 21, Anm. 1; § 24, Anm. 1; Kaufmann, *op. cit.*, p. 54.

enquire into its adequacy, even at the instance of a liquidator[1]). In fact it is therefore impossible to be given a remedy by the Court if one is not able to prove that the overvaluation was due for instance to fraud or an illusory consideration. The reason given by STIEBEL[2]) is that "a person who sells to a company may sell at his own price just as any other vendor can, and the Court cannot make a fresh bargain for the parties".

It must however be pointed out that where public interest has been much at stake, the necessary measures had to be provided by the special Statutes themselves (e.g. Sect. 7 of the Railway and Canal Traffic Act, 1854, or in case of certain contracts made by infants)[3]). Accordingly, the burden of scrutinizing the consideration as to its adequacy was conferred upon the Court. But these are few exceptions to the doctrine described: the consideration must be *real* but *need not be adequate*[4]).

In *Re Wragg* it was however established that:

when the agreement has been induced by fraud,

or the consideration given to the company has been illusory,

or the consideration—on the face of the agreement [induced by fraud]—is not equivalent to the actual value of the shares,

the Court can *go behind* the agreement, whether a contract has been registered or not. Any person to whom shares are alloted on the face of such kind of contracts, may be held liable to pay for the shares in full[5]). Thus, the interference of the Court has only been held appropriate in case of fraud etc.. Prof. KAHN-FREUND[6]), however, claims that "the positive and effective solution" is to have also the *adequacy* of the consideration scrutinized by the Court.

The measures described are altogether merely an application of the *Law of Contract*. This is to be noticed. In the case of fraud by a creditor, the contract thus is void according to general principles of public policy[7]). If a member innocently misleads the company, the agreement is likely to be voidable; in case of an illusory consideration, total failure of consideration may be held to exist.

One will ask in vain for provisions or precedents giving any other safeguards to the creditors. How are they to be protected if for instance a notoriously insolvent member of the company is some day held liable to pay cash in full for having contributed to the "watering" of the assets by some fraudulent agree-

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[1]) PALMER, *Precedents*, p. 207; *Pell's Case* (1870), L.R. 5 Ch. App. 11; *Baglan Hall Colliery Co.* (1870), L.R. Ch. App. 346; in Re *Wragg Ltd.*, [1897] 1 Ch. 796.

[2]) *Company Law and Precedents*, pp. 199–200 and quoted cases (p. 200 [s]).

[3]) E.g. *Clements* v. *LNW Ry Co.*, [1894] 2 Q.B. 482, quoted by Prof. KAHN-FREUND in *Modern Law Review*, vol. 7, p. 64.

[4]) *Re Wragg*, [1897] 1 Ch. 796, as there formulated.

[5]) Compare also *HongKong & China Gas Co.* v. *Glen*, [1914] 1 Ch. 527; *Re James Pitkin & Co.* 1916), W.N. 112.

[6]) *Modern Law Review*, vol. 7, p. 64.

[7]) *Alexander* v. *Rayson*, [1936] 1 K.B. 169.

ment? The other members of the company who may be able to cover the outstanding amount cannot be sued: there is no joint liability for that purpose. The principle of the Public Company is maintained and the members' liability is limited to the payment of the company's own shares.

III. On Reform proposals in English Law

The Continental lawyer who is accustomed to an almost overcautious solution of the problem may be tempted to propound various remedies. He may read Prof. KAHN-FREUND's highly critical article [1]) written at the time of revision of the Company Act, 1929. Prof. KAHN-FREUND insisted strongly that this topic of English Law needed reforming. The arguments put forward are convincing; at any rate, one very shrewd remark cannot be omitted: the exceptions described in case of fraud introduce a "*subjective element*" through which the inquiry into the adequate value of the assets is replaced by scrutinizing the state of mind of the two parties. This renders the Court's task much more intricate and unfortunately less effective [2]). The remedies proposed by Prof. KAHN-FREUND are: sanction of an independent authority—the Board of Trade—; liability to pay cash in full until the provisions for publicity have been complied with in full; detailed valuation of the assets.

To this it may however be remarked that public control and provisions of rigid valuation standards do not square with the nature of a Private Company. One of their typical features is the release from certain formal requisites. Sanctions by an official board or cumbersome valuation do not suit for example a small family business incorporated as a company. The Swiss Legislator, be it said in passing, therefore preferred comparatively simple and flexible rules of valuation which do not hinder a smooth formation of the S. à R. l.; owing to the subsidiary joint liability of the members, effective guarantee nevertheless is given to the creditors.

As to Prof. KAHN-FREUND's proposals, it is furthermore to be remarked that the *intimacy of family business* should be respected. This problem of intimacy arose actually in respect of the exemption of Private Companies from the obligation to file accounts. In spite of opponents to the exemption, a solution had to be found in order to maintain secrecy of accounts which is vital at least for small family businesses [3]). Finally it should also be noted that changes in the *balance of rules* in the matter may at once provoke a considerable change in the legal nature of the S. à R. l. or the Private Company itself. Thus the whole institution may be shifted in its economic significance and in its social function. That is

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[1]) *Modern Law Review,* p. 7, 62 et seq.

[2]) *Modern Law Review,* p. 64.

[3]) *Cohen Report, supra,* p. 27, N. 53; p. 28 recommendations, Sect. 129, subs. 2, 7th Schedule. See for Swiss Law, GOELDLIN DE TIEFENAU, *op. cit.,* p. 87; the proposal of rendering possible the immixion of expert valuers was dismissed on the same ground.

what we should keep in mind, when following De Sola's [1]) conclusions recommending for legislation the *combination* of official control with joint liability of the members. It is submitted that De Sola's proposal does not take notice of the existent interdependance. Important changes in the character of the traditional shape of S. à R. l. or Private Company could not be avoided. The Legislator should at any rate be aware of these possible consequences. The need for intimacy of business, for flexibility and balance of rules have been in our submission the main reasons why no amendment was made in Parliament on the occasion of the passage of the new Company Act, 1948 [2]). This is also the way by which the continental lawyer should approach the problem, as set in English Law. It certainly is difficult for the foreign student in English Company Law to feel at ease in the English creditor's place. The foreigner is accustomed to rely upon the security offered by the members' liability according to most of the modern Laws (Art. 802 C.O.). We are used to consider these provisions as a necessary consequence of the lacking stringency of valuation rules; but we would be mistaken in believing that any of our legal rules of that kind could easily be introduced into the system of the Private Company. As we have already seen, the described joint liability of the members (Art. 802 C.O.) is inconceivable in English Private Company Law, the system thereof being exactly established according to the Public Company's.

Finally, it is to be pointed out that, whereas the tendency is to increase the rigour of the rules on the Continent, nothing at all was changed through the Act of 1948 in England [3]). This is another consequence of the Legislator's attitude as it has been described above. The fact is, nevertheless, that the provisions of the Act, as to non-monetary payment for shares, left the way open to numerous abuses against prospective creditors or fellow members of the Company. English lawyers themselves agree upon this critical state of affairs. But it does not seem to be as urgent as in Germany where the woeful reputation of the G.m.b.H. is to be explained mainly by a loophole in the Law.

IV. A few other questions connected with non-cash payment must be briefly dealt with.

In Switzerland 50% of the issued capital must be paid up before application and no distinction is made between money payment and payment otherwise than in cash [4]). Non-cash value can therefore also be *partly* made over to the company on condition that the 50% prescription is respected. Apart from the fact that no minimum payment is provided, the same is to be said for the Company Act (so in French Law: Art. 7 (1925)).

In German Law, however, the question of equal treatment is contested. The

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[1]) De Sola, *op. cit.*, p. 359.

[2]) There was no recommendation by the Cohen Committee Report either.

[3]) *Minutes of Evidence* taken before the Company Law Amendment Committee (Company Act, 1929), 22nd day, No. 11005, per Mr. Cohn.

[4]) Art. 774/2 C.O.: "versement en argent ou apports en nature".

Law does not give a clear solution (§ 8/1). The predominant view taken by writers and Courts inclines to a full integration of non-cash payment [1]).

From the practical standpoint, however, the problem is of considerably less importance: payments in "kind", like a business, a concession etc., will—with regard to their nature—hardly be integrated partially only.

It goes without saying that the total value of "apports en nature" is limited in Swiss Law by Art. 773 C.O. which provides a minimum and maximum limit of the nominal capital.

A further measure to secure the effective integration of capital on application is the restriction of the possibility of non monetary payment. This was the line taken by Austria and Hungary [2]).

Sect. 182 of the Companies Act, dealing with the qualification shares of directors is not compulsory, although the Company's Articles usually contain a provision establishing liability to pay in cash. Here, however, the purpose is definitely the insurance of the directors' interest in the enterprise [3]). This is to be duly distinguished.

FIFTH CHAPTER

THE MAINTENANCE OF CAPITAL

In the former chapter we have seen how the necessary capital was to be raised, that is, how the real availability of the guarantee fund—in its function as base for credit and liability—was to be secured. The established provisions however are meant to be effective only for the period of the setting up of the company. But which is the right manner of maintaining the capital when the company has once commenced business? How shall this minimum financial base be kept constant notwithstanding "slumps" in business relations? How should it be protected against underhand dealings of dishonest directors during the management? It is easy to recognize that an additional set of rules is needed, once the enterprise has been launched, since the risks to which the capital is exposed are in fact more numerous than at the time of formation. A guarantee for the *raising of capital* would be illusory without provisions securing its *maintenance*. Accordingly, rules aiming at the prevention of the diminution of the nominal capital have been devised by all legislators in Company Law. The prevailing purpose is usually the *creditors' protection*.

Infringements of the duty enjoined on directors and members to preserve the company's capital consist broadly speaking in *disallowed returns* to the members of the company.

[1]) HACHENBURG, "*Kommentar*", Anm. 14b, 15, 16 zu § 7; the same is to be deduced from Art. 120 of the Belgian Law, 1935.

[2]) Austria: half the nominal capital at least has to be paid up in cash only (Art. 6, "Gesetz" 1906; modified Art. 246, "Gesetz" 1924).

[3]) *Modern Law Review*, vol. 7, p. 61.

Three cases have to be distinguished:

(i) payment of *dividends out of capital assets* (e.g. *Bond* v. *Barrow Haematite Steel Co.,* [1902] 1 Ch. 353; and several other cases).

(ii) payment of *interest out of capital* (Art. 804/2 C.O.) except under certain safeguards (Sect. 65 of the Act, corresponding to "Bauzinse", Art. 804/2 C.O.).

(iii) other returns of capital (in the narrower sense) including the purchase by a company of its own shares (*Trevor* v. *Whitworth* (1887), L.R. 12 App. Cas. 409), the allotment of shares at a discount (*Ooregum Gold Mining Co.* v. *Roper and Wallroth,* [1892] A.C. 125), the release of the liability to pay for calls (per LINDLEY, L. J., in Re *Wragg Ltd.,* [1897] 1 Ch. 796 at p. 829; CLAUSON, L. J. in Re *White Star Line,* [1938] 1 Ch. 458 C.A.).

In Switzerland the provisions relating to return of capital are set out in Art. 802, 804 of the C.O. In English Company Law, the Courts have imposed the required rules outside the Statute Book. The principles laid down in the cases cited above are considered to be *restrictions on freedom of contract* between the company and its shareholders according to the needs of "general policy of the Law" [1]).

The problems connected with promise of *dividends out of capital* are numerous. We shall be concerned with them in some detail, not only because English and Swiss basic conceptions disagree fundamentally, but also because dividends nowadays represent for an increasing number of individuals an important part of their *income* [2]).

Further questions as to the other possibilities of return of capital will be dealt with more briefly.

PART I

THE PAYMENT OF DIVIDENDS OUT OF CAPITAL

§ 13. THE CONTINENTAL CAPITAL MAINTENANCE RULE AND THE SWISS PROVISIONS

In the S.A. and S. à R. l. the rules as to *declaration of dividends* ("bénéfices") are the same (C.O. Art. 804; 805 referring to Art. 660 et seq. of the S.A.; there is only one exception in Art. 806 C.O. which is to be treated below). Although some rather difficult question of accountancy may arise, the basic principle seems to be clear and unquestioned. In English Law however, Legislator and Courts were already looking for new solutions at an early date. A series of rules have been developped which are quite unusual in Continental Law.

We shall rapidly examine the provisions of Swiss Law.

The illegal distribution of profits infringes the duty to preserve the capital of the company, but profits made available for dividends ("bénéfices") according to the compulsory provisions of the Art. 804, 805 and 660 et seq. C.O. are legal.

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[1]) Compare *Modern Law Review,* vol. 7, p. 60.
[2]) *Modern Law Review,* vol. 4, p. 273, 289.

The golden rule is that the nominal capital must be maintained intact. With its diminution by any amount, the whole apparatus of liability (Art. 802 C.O.) may be set in motion. The *capital maintenance rule* is generally recognized on the continent (see e.g. Germany: § 42 of the G.m.b.H. Ges. "Prinzip des festen Stammkapitals"). The net profit to be distributed must be established in compliance with exact principles of valuation (Art. 666 et seq. C.O.), and the statutory reserve fund is to be considered therein (Art. 671 C.O.).

The capital maintenance principle is expressed in the accountancy provision, that *the nominal capital and the various reserve funds are to be set up as debit items.* The *full amount* of the nominal capital, as stated in the "statuts" (and issued), without deduction of the company's own shares and shares still to be paid for, must be taken into account. The amount which has not yet been called is to be stated on the credit side (Art. 668/2 C.O.). Thus the nominal capital is a constant "nominal factor" [1]), which is charged as a passive item of the annual accounts. Subject to a reduction or increase in due form, the capital is entirely insulated from varying success in business and it is also isolated from changes in the value of the money or the "apports en nature" paid or made over to the company on allotment. Revenue account cannot be carried over to capital account. Profits are available for dividends only if the capital account is in credit. Therefore it is easily conceivable that net profit (available for dividends) cannot be declared, although the annual revenue account is in credit [2]).

These rules are altogether well established. That is a reason why for example the article in the project of Law 1928 providing that the nominal capital is to be stated in the described manner as a *debit item* was eventually dropped in the definitive draft: the rule was considered obvious [3]).

§ 14. THE HISTORICAL DEVELOPMENT UNTIL 1889 IN ENGLISH LAW

I. The Continental lawyer is surprised to see how little his conception on capital maintenance and dividend policy nowadays is appreciated by the English Courts which are inspired by a string of authorities—to begin with the *Lee* v. *Neuchâtel* case [4])—setting forth a doctrine quite unfamiliar to him: "It would be most inexpedient", it is said for instance in one of the classical dividend cases [5]), "to lay down a hard and fast rule, which would prevent a flourishing

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[1]) "Ideelle Grösse".
As to the various functions of the nominal capital in Swiss Law, compare e.g. W. Schmid, "*Das feste Grundkapital der Aktiengesellschaft*", p. 4–10, and the literature there quoted.

[2]) The method of assessment of profits for the S.A. and the S. à R.l., which is envolving the whole business activity of the company from the time of commencement of business until the date of the present assessment, is called "absolute Gewinnberechnungsmethode" as opposed to the "relative Gewinnberechnungsmethode" applied to the sole trader and the "société de personnes". Compare W. Schmid, *op. cit.*, p. 72 et seq.

[3]) *Commentary* Janggen-Becker, Art. 772 N. 18.

[4]) *Lee* v. *Neuchâtel Asphalte Co.* (1889), 41 Ch.D. (C.A.); Conf. *infra*, § 15.

[5]) Per Lindley, L.J., in *Verner's* case, [1894] 2 Ch. 239, at p. 265.

concern, either not in debt or well able to pay its debts, from paying dividends so long as its capital sunk in creating the business was not represented by assets which would, if sold, reproduce in money the capital sunk."

As it is the case for a good number of English institutions (see e.g. the "ultra vires" doctrine), it is difficult to obtain a clear view of the English conception regarding ascertainment of dividends and preservation of capital without analysing first its *historical evolution.*

II. It was recognized from the beginning of the development of modern Company Law that an exceptional danger existed in the undermining of the company's capital by improper payment of dividends. Thus, according to a fundamental rule established even before the Companies Act, 1862, the company was forbidden to distribute among its shareholders any part of its capital as had actually been paid up [1]), except, of course, by leave of the Court. As long as the capital remained intact, nothing could prevent the company from distributing as dividends any increase which could be declared legally available for dividends [2]).

Such principles however could not be found explicitely in any section of the Companies Acts. On the contrary, the rule—we shall call it "capital maintenance rule"—was deemed to be an application of the "ultra vires" doctrine [3]). Accordingly, the capital may be spent only for the furtherance of the objects defined in the memorandum. The objects evidently do not imply the return of capital to the shareholders to the creditors' detriment. Expenditures beyond the objects are "ultra vires" the company and imply a reduction of the fund available as guarantee for the contingent creditors' claims.

Beside the conception that the "ultra vires" doctrine applied, some other quite accurate explanations of the rule of capital maintenance were also given at about the same period. Thus it has been said that any Limited Company "impliedly represents to or contracts with its creditors that it has a capital of a certain value and cannot therefore go back from such contract or representation" [4]).

In the same line of thought, we find in *Flitcroft's Case* [5]) the argument that the "intention of the Law" to maintain the capital intact is clearly shown in the Act, since an order of the Court is necessary for a reduction of capital. Hence one could at that time easily find good reasons on which the rule of capital maintenance could be based. But we shall see below how dangerous it is to apply

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[1]) *Evans* v. *Coventry* (1856), 25 L. J. (Ch.) 489.

[2]) *Lubbock* v. *British Bank of South America,* [1892] 2 Ch. 198.

[3]) Compare Appendix III, p. 84.

[4]) *Macdougal* v. *Jersey Imperial Hotel Co.* (1864), 2 H & M 528. The distribution of dividends was "not in accordance with the contract entered into with the legislature on behalf of the public..." (p. 571) ... "whereby it was determined that the shareholders should be liable to a certain defined amount and no more, to the creditors of the company, and not in accordance with the contract between the parties, whereby each shareholder was protected against creditors to the extent of the contributive liability of all the others" (per Lord HATHERLEY at p. 535); see also A. STIEBEL, *Company Law,* p. 73 (a).

[5]) *Flitcroft's Case* (1882), 21 Ch.D. 519 at p. 533.

"the general intention of the Law" without running the risk of obtaining possibly ambiguous results.

The state of the Law in the first period until 1889 may be summed up by saying that dividends or other payments to shareholders may be paid out of any assets of the company, as long as they are not paid out of issued capital, subject of course to provisions in the articles. This applies to any debts which are payable only out of profits: the result of a payment out of capital would be the increase of the amount out of which dividends unfairly are to be paid in the future [1]). The general trend at that period was to give the creditor some protection against the corporation which is—to use the words of Lord JESSEL, M.R.[2])—"not a debtor, but that impalpable thing, which has no property except the assets of the business...".

Before analysing further developments of dividend Law, we intend to quote the rules set forth in two earlier and two more recent cases, which are still valid to-day and are not directly connected with the shift of conception occasioned by the *Lee* v. *Neuchâtel Case* [3]) concerning the capital maintenance rules. The case of *Lubbock* v. *British Bank of South America* [4]) shows that where a company has sold part of its undertaking, the price of which exceeds the paid-up nominal capital, the balance may be carried to profit and loss and be divided as dividend.

If a company estimates that it has made profits on a bona fide ground, *it may pay dividends* out of it, although the assets were not yet realized, so that the company had actually to borrow money to pay them [5]). Dividends may also be paid out of profits, when the directors reasonably and honestly come to the conclusion that some part of the assets has increased in value and is carried to profit and loss subject to an intact capital [6]).

There is no obligation to call on experts for the valuation [6]).

§ 15. THE LEE v. NEUCHATEL CASE

I. The case discussed

A new development started in 1889 with the *Lee* v. *Neuchâtel Asphalte Case* [7]) which abandoned the established strict rule that every decrease of the value of the assets was to be deducted from the assets available for dividends (as in

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[1]) *Bury* v. *Famatina Development Corporation,* [1909] 1 Ch. 754 (C.A.); affirmed sub nom. *Famatina Development Corporation* v. *Bury,* [1910] A.C. 439 (H.L.).

[2]) *Flitcroft's Case, supra,* at p. 533.

[3]) *Lee* v. *Neuchâtel Asphalte Co.* (1889), 41 Ch.D. 1.

[4]) *Lubbock* v. *British Bank of South America, supra.*

[5]) *Stringer's Case,* in Re Mercantile Trading Co. (1869), 4 Ch. App. 415; the decision hinged upon whether it was proper for a company to have paid dividends on the faith that a debt incurred by the Confederate Government during the American civil war was valuable. Events proved that the debt was worthless.

[6]) *Ammonia Soda Co.* v. *Chamberlain,* [1918] 1 Ch. 266 (C.A.).

[7]) *Lee* v. *Neuchâtel Asphalte Co.* (1889), 41 Ch.D. 1 (C.A.).

Flitcroft's case). The facts of the *Lee* v. *Neuchâtel Case* are the following. A company was formed to acquire and work a concession from the Neuchâtel Government for quarrying bituminous rock and mineral products. The concession was due to expire in 1907. In 1887 there was a profit shown on revenue account and the company proposed to pay a dividend. This was objected to on the ground that (i) a large part of the capital had been lost, (ii) the assets were not equal to the share capital, and (iii) the concession being a wasting asset, dividing its annual proceeds was dividing the capital assets of the company. Held: *the company could declare dividends without any restrain.* This judgement meant of course a complete volte-face.

As against the previous cases it was first of all argued in the Court of Appeal that there was no provision in the Act of 1862 to impose any duty on a company to *replace lost capital* [1]), but that it was in effect the intention of Parliament not to interfere with the principles for the computation of the fund available for dividends, and that the silence of the Law was to be interpreted as a "conscious desire" [2]) not to impose its opinion on a matter which was left "and very judiciously and properly left to the commercial world" [3]). It is not, according to LINDLEY, L. J., a subject for an Act of Parliament to say how accounts are to be kept; what is to be put into capital account, what into an income account, is left to men of business [3]).

Beside the fact that from now onwards, it was upon the business men, more exactly the directors and accountants, that the duty of solving the "technical" business problems of dividend computation was conferred, the *Lee* v. *Neuchâtel Case* still puts forward other new conceptions which need some comment. With regard to the provisions in the articles of the Neuchâtel Asphalte Co.

"that the directors shall not be bound to form a fund or otherwise reserve moneys for the renewal or replacing of any lease, or of the company's interest in any property or concession" [4]),

the question was whether such provision was illegal. The Judge of the Lower Court thought so [5]), having regard to the fact that the assets of the company were *wasting property* and had to be replaced (e.g. a mine, a quarry, patents, and in this case the expiring concession).

In the Court of Appeal however, LINDLEY, L. J., disagreed. Apart from the economic consideration that the upholding of the capital maintenance rule "would paralyse the trade of the country", his judgement is—as in former cases—an interpretation of the silence of the Act as regards dividend rules. But his opinion

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[1]) No provisions were contained in the Acts, but only appendices in the form of Tables and Schedules; for the Companies Act, 1948: Table 116, which provides that "no dividend shall be paid otherwise than out of profits". This rule however is only optional.

[2]) *Modern Law Review*, vol. 4, p. 278.

[3]) Per LINDLEY, L. J. in *Lee* v. *Neuchâtel, supra,* at p. 21.

[4]) It may be useful to note in this connection that the formation of statutory reserves is not provided for in English Company Law, as against Continental Law (so in Swiss Law, Art. 805 referring to Art. 671–674 C.O.; in German Law, §§ 41, 42).

[5]) (1887), before STIRLING, J.

on the intention of the Legislator is diametrically opposed to the previously accepted conception. Several rules and arguments are worth noting [1]).

First we shall deal with an argumentum e contrario which is in our submission devoid of ground: in favour of the conception that the Legislator did not intend to establish a strict rule of capital maintenance, it is argued that there is not even any provision in the Act aiming at the winding up of the company in case of loss of its capital [2]). In return, one cannot help asking which could then be the purpose of the same Legislator, when he provided that a company may only *reduce its capital* by a special resolution and subject to the *sanction by the Court* (Sect. 66 of the Act)! The criticised argument seems to have been picked out "pour les besoins de la cause".

In the second place, we shall discuss that part of the judgement of LINDLEY, L. J., which gives to the "Lee-Rule" a legal definition which is as elegant as concise: *The company is not debtor to capital.*

The company may only become debtor to the shareholders in case of a surplus of profits to be distributed as dividends when all the claims of creditors are satisfied. The idea is that the directors will no more be compelled to secure the total amount of the nominal capital. The capital maintenance rule is replaced by the criterion of "*mercantile prudence*" of directors, who will have to manage the business so that payment of creditors can be effected in the case of winding up, independently from the question whether the full capital amount is still available or not. The directors, when properly using their "mercantile prudence", only have to respect [3]) the general principle of the "ultra vires" doctrine, which says that capital can only be used for purposes stated in the memorandum of association.

All this does not mean, as LOPES, L. J., remarks [4]), that if the expenses of working exceed the receipts, the accounts must for example be made out so as to show an apparent profit and so enable the company to pay dividend out of capital.

These are the main issues of the *Lee-Case* which were to influence fundamentally the development of the Law relating to capital and dividends. The present stage of the Law however cannot be understood without considering several later cases which have also been decisive.

II. Subsequent development

The *Lee-Case* was radical in its findings. In a case [5]) which occured three years later, the Judges seemed to reswear allegiance to the overruled principle of capital maintenance. They drew the distinction that the Lee-rule applies only

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[1]) *Lee* v. *Neuchâtel Case, supra,* at p. 19, 22, 23.

[2]) Compare e.g. Swiss Law as to measures to be taken by the directors in case of losses of capital: Art. 817, 725 C.O.

[3]) Subject to purposes expressly or impliedly forbidden by the statutes.

[4]) *Lee* v. *Neuchâtel Case, supra,* at p. 27.

[5]) *Lubbock* v. *British Bank of South America,* [1892] 2 Ch. 198.

to companies formed to work a *wasting property* (diminishing according to its nature), but that in the other cases, *lost capital must be replaced.* CHITTY, L. J.[1]), says that every company (subject to a capital having been formed with wasting property) has to respect the requirements of the Companies Act, 1862, which is to keep its capital intact for its creditors and therefore not to pay dividends out of it. Thus, the rule in *Flitcroft's case* and the "intention of the Law" as it was interpreted therein, seemed to be reestablished.

This "restauration" however was a short one: the development of the dividend Law tended markedly towards the alleviation which had found its expression in the "Lee-rule". Hence the following cases[2]) turned again to the conception that profits may be available even though there is an insufficient amount to cover in the balance-sheet the debit item of share capital[3]). These decisions are now rather strongly established.

The development of the Lee-rule culminated in *Stapley* v. *Read Bros.*[4]), where it was held that even the distribution of profits of a particular year was allowed without making good losses of previous years on Profit and Loss Account. So the results of each period of trading are treated separately[5]).

It is possible that the decision in *Stapley* v. *Read Bros.*[4]), since it reaches the borderline of what can be conciliated with "mercantile prudence", may be overruled once again by less free conceptions[6]).

§ 16. PROFITS AVAILABLE FOR DIVIDENDS, QUESTIONS OF ACCOUNTANCY

I. The doctrine established in Case-Law that the assessment of profits is primarily a *business question* for the directors or shareholders "who are expected to act honestly and in accordance with regulations of the company"[7]), implied

[1]) *Lubbock* v. *British Bank of South America, Supra,* at p. 202–203.

[2]) *Verner's Case,* [1894] 2 Ch. 239, per LINDLEY, L. J., at p. 239. (The arguments of Lee v. Neuchâtel are reiterated).

In Re National Bank of Wales, [1899] 2 Ch. 629 (C. A.), on appeal, [1899] 2 Ch. 651, affirmed sub nom. *Dovey* v. *Cory,* [1901] A.C. 477 (H.L.), where advances to impecunious clients in previous years were ignored (subject to "moral obliquity").

Bond v. *Barrow Haematite Co.,* [1902] 1 Ch. 353, where the same principle applied. It was however decided by the Court on evidence that mines, blast furnaces and cottages were in the circumstances to be regarded as "circulating capital". It is interesting to note that insistance was laid on the fact that the answer can be given only according to the circumstances of the particular case ("no hard and fast rule"). This had of course the effect of weakening the Lee-principle.

Ammonia Soda Co. v. *Chamberlain,* [1918] 1 Ch. 266 reverted thoroughly and unambiguously to the application of the Lee-rule.

[3]) Compare BUCKLEY, *On the Companies,* p. 903: "wasting property is not necessarily a revenue charge." Idem STIEBEL, *Company Law and Precedents,* p. 77.

[4]) *L. T.* (1924), 2 Ch. 1.

[5]) As soon as the company has "turned the corner" dividends can be paid again (*Modern Law Review,* vol. 4, p. 285).

[6]) Compare STIEBEL, *op. cit.,* p. 77.

[7]) *Dovey* v. *Cory,* [1901] A.C. 477, reported as *National Bank of Wales,* [1899] 2 Ch. 629 in the lower instance.

that the Accountants were to be called into play. They were to give to the new principle its expression in accountancy technique, a task which they fulfilled at first somewhat reluctantly [1]). The system of rules developed remains beyond the scope of our analysis. Some remarks should however be made on the *contribution of the Courts* to the problem. This contribution has remained comparatively modest since the House of Lords always declined to attempt the treatment of these questions in the abstract; "the modus and manner in which a business is carried on and what is usual or the reverse may have a considerable influence in determining the question, what may be treated as profits and what as capital" [2]).

However little the House of Lords was inclined to settle solid rules of accountancy, several attempts were made to sift some valid principles from the bulk of cases involved in the matter. One of these attempts at any rate seems to be worth noting: it introduced the distinction between *fixed* and *circulating capital*, a notion which is very often used in textbooks and dividend cases, although it only reaffirms in other words principles which had been elaborated before [3]). *Fixed* capital, as Swinfen Eady, L. J., defines it [4]), is fixed in the sense of being invested in assets intended to be retained by the company more or less permanently and used in producing an income. *Circulating or floating capital*, according to *Stapley* v. *Read Bros.*[5]), is a portion of the subscribed capital of the company, intended to be used by being temporarily parted with and circulated in business, in the form of money, goods or other assets, and which, or the proceeds of which, are intended to return to the company with an increment and to be used again and again, and always to return with some accretion (intention of resale or sale at a profit) [6]). The rule established by Lindley, L. J.[7]) on the base of these definitions is that *fixed capital need not be made good*: it may be sunk and lost. But the capital consumed in producing (floating) *must* be replaced before a dividend can be paid out of the excess. As we have already pointed out, the (described) distinc-

[1]) The "Lee-rule" was described as "simply startling", the most mischievous judgement ever given in company matters (*The Accountant* [1889], p. 89); 30 years later, however, after the *Ammonia Soda Case*, the same rule is said "likely to be convenient in practice" (*The Accountant* [1918], vol. 57, p. 418). Compare detailed quotation in *Modern Law Review*, vol. 4, pp. 278, 280, 281, 283, 285.

[2]) *Dovey* v. *Cory, supra* (per Lord Halsbury).

[3]) Per Lindley, L. J., in *Verner's Case* (v. General and Commercial Investment Trust), [1894] 2 Ch. 239. The business of a company was to invest its funds in shares and other securities, its income being derived from the dividends on the shares it held. Owing to a fall in market values, the assets of the company greatly depreciated in value, but the income for the year exceeded the expenses. Action was brought on behalf of the debenture holders to restrain the company from declaring a dividend, without first providing for the loss of capital. Held: the loss was a loss of *fixed* capital, and need not be made good before a dividend was declared.

[4]) *Ammonia Soda Co.* v. *Chamberlain*, [1918] 1 Ch. p. 266 (C. A.), at p. 286. Compare also Marshall's definition in "*Principles of Economics*", p. 134: "exists in a durable shape and the return to which is spread over a period of corresponding duration" (quoted in *Verner's Case* at p. 366).

[5]) *Stapley* v. *Read Bros.*, [1924] 2 Ch. 1.

[6]) Marshall, *ibid.* "which fulfills the whole of its office in the production in which it is engaged by a single use".

[7]) *Verner's Case, supra*, at p. 266.

tion between fixed and floating capital and L. J. LINDLEY's rule does not however set forth new principles relating to dividend payment. The expressions "floating" and "fixed" capital describe only the purpose to which the capital is actually devoted, and thus determine which part of the capital (in its broader meaning) is available for dividends [1]). The rule does after all only mean in other words that dividends must be paid out of *net profits* (Gross amount less expenses of sale including money used in buying goods for sale).

II. As regards Swiss Law, the determination of profits is also deemed to be a matter regulated by the commercial world. Accounts and balance-sheet, which are the base for ascertaining profit available for dividends, must be drawn up according to *generally recognized principles of business* [2]). The provisions in the S. A. Law, Art. 662–674 C. O.—which also apply to the S. à R. l., Art. 805 C. O.—and the general rules in Art. 958–961 C. O. are only a small selection from the great bulk of commercial usages [3]).

However, as compared with English Law, the range of application and significance of these commercial rules is much narrower, since the principle of capital maintenance, as applied in Swiss Law, excludes a priori the whole sequence of problems connected with the consequences of the Lee-rule.

The distinction made between fixed and circulating capital corresponds to the "Anlagevermögen" and the "Umlaufsvermögen" only in being set out in the balance-sheet according to *different bases of valuation* (Art. 665–667 C. O.; Sect. 149 of the Act and 8th Schedule, Part I, Subs. 4 et seq.).

§ 17. PRESENT STATE OF THE LAW

I. One may search in vain in Textbooks and in Precedents for the *exposition of the present state of dividend Law*: the commentators excel in juxtaposing numerous quotations from the famous cases, but they are unexpectedly cautious when advancing their opinion in a matter in which the Judges, with the introduction of the Lee-rule, purposely abandoned the more solid ground of capital maintenance.

Several rules have been well established by the Courts such as: "fixed capital *(Ammonia Soda Case)*, or even circulating capital when representing losses in previous years *(Stapley* v. *Read Bros. Case)* need not be replaced"; or, "unrealised increases in the value of fixed assets may, in some cases, be declared as dividends" *(Ammonia Soda Case)*. These rules however have clearly defined the freedom of

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[1]) *Bond* v. *Barrow Haematite Co.*, [1902] 1 Ch. 353; the remark of SCRUTTON, L. J., *Ammonia Soda Co.* v. *Chamberlain*, [1918] 1 Ch. 266, at pp. 295, 297, seems to be justified. Compare also BUCKLEY, *op. cit.*, p. 902.

[2]) Art. 959 C. O.: "Le compte d'exploitation et le bilan annuel sont dressés conformément aux principes généralement admis dans le commerce; ils doivent être complets, clairs et faciles à consulter, afin que les intéressés puissent se rendre compte aussi exactement que possible de la situation économique de l'entreprise."

[3]) Compare GUHL, *Le Code des Obligations*, p. 592. JANGGEN-BECKER, *Commentary*, Art. 805, N. 2.

the directors only unilaterally. On the other side they purposely committed to the directors' discretion the care of selecting the applicable rules of accountancy likely to determine how much of the capital was at least to be reserved [1]). The Commentators in fact are aware of this far-reaching discretion and of the dangers involved [2]). They do not therefore neglect to emphasise that, in practice, the Lee-rule only applies subject to the ascertainment of the profits of the company on the ground of *sound business principles*. The directors do not distribute profits without putting aside reasonable reserves for meeting losses on capital [3]), or as says for example BUCKLEY [4]): "The creditors of the company are entitled to have the *capital account fairly and properly kept*" (and of course revenue losses must not be dishonestly thrown on capital in order to swell dividends). Sometimes the appliance of general rules of the Law is suggested: payments of dividends which would "precipitate the company's insolvency" are *illegal* [5]). One of the weaknesses of all these considerations is that they seem to take honesty and common sense for granted. Furthermore, even if rules of accountancy relating to dividends have once been carefully established, it appears that they usually are "neither clear-cut, nor definite, nor easy of application..." [6]). Uncertainty therefore may be created in borderline cases and the directors may abuse the freedom given to them in keeping insufficient funds to meet the claims of the creditors.

II. From the Swiss standpoint (and also in general from the continental standpoint) with the capital-maintenance rule so strongly established, it may be difficult to appreciate the effect and advantages of the Lee-rule series of decisions. The whole system of Swiss S. à R. l. Law is governed by the idea that the *creditor must be protected above all*. Dividends ("bénéfices") can therefore only be declared as long as the remaining assets (valued according to generally recognized accountancy conventions) are at least equal to the nominal capital [7]).

In England however, the historical analysis of the series of cases connected with the Lee-rule shows that by the nineties of the last century commercial Law was influenced by *liberal trends* [8]) which shifted the emphasis from the creditor's protection to a more flexible and free conception. Upon business men was de-

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[1]) Compare *Dovey* v. *Cory*, [1901] A.C. 477, the judgement delivered by Lord HALSBURY; *Lee* v. *Neuchâtel Case, supra*, at p. 21.

[2]) "The directors' discretion is evidently to be the ultimate Court of Appeal", *Modern Law Review*, vol. 4, p. 285.

[3]) PALMER's *Company Law*, p. 204; BUCKLEY, *op. cit.*, "... be honest and within legal limits", p. 901.

[4]) BUCKLEY, *op. cit.*, p. 906.

[5]) *Modern Law Review*, vol. 4, p. 290; compare also STIEBEL, *op. cit.*, p. 71–79.

[6]) *Modern Law Review*, vol. 4, p. 288; for example: A well-established rule of accountancy is that normal wear-and-tear depreciation must be deducted from the dividend fund. There is, however, no unanimity on this point in the Courts.

[7]) This was also the state of English dividend rules until 1889; *Modern Law Review*, vol. 4, p. 285.

[8]) After a first important breach of the continental, financially conservative tradition in the Companies Act, 1856 (compare p. 76) this was, on this major question, a further step in the same line of development.

volved the care of finding the proper balance between regular payment of dividends and the creditors' interests. It is true that the arguments given at that time for this new idea are not altogether satisfactory, especially in the attempt to justify the Lee-rule according to the supposed intentions of the Legislator, which, in our submission, seems to incline much more to the old conception. However, instead of suggesting a change of the Law *at legislation*, the Courts preferred to meet the need for liberalization of the dividend rules in doing violence somehow to the established basic principle of maintenance which was, it is submitted, in the spirit of the existing Statute Book. Once the Law Lords were convinced that the capital maintenance rule would "paralyse the trade of the country", there was indeed a sufficient reason to take appropriate measures. Since then the rules in English Law as to capital and dividends have constantly devoted considerable care to facing the necessities of the welfare of the general economy. It may be surmised that it is partly to the detriment of the security of the creditors; but the advantages of the English solution should not be belittled.

Thus, with regard to the smooth relation between directors and shareholders, the need for *regular payment of dividends* is an important consideration, since dividends received from the company represent an increasing part of the individual's income [1]). To the directors is given the possibility of regulating the payment of dividends, although capital account is not in credit, subject to their duty to retain sufficient assets to face the creditors' eventual claims. This may be useful in case of changing fortunes in business or when difficulties arise in rendering profitable—in the strict sense of the word—the business in its infancy (so-called preliminary expenses). The system of "watertight compartments" [2]) is inconceivable in Swiss Law. The directors therefore are unable to follow a dividend policy as adaptable to the trade's needs as in England [3]).

A further consideration which is strange to Swiss Law, is that *mobility of capital* should be maintained. Accordingly, the dividend rules should not hamper the transfer of parts of capital when no more needed for the trade of the company. It would be advisable to "redirect" [4]) capital towards other opportunities of investment, instead of leaving it linked up without advantage with the original company.

Through *winding-up of the company or reduction of capital*, assets could also be made available. But these processes are not to be recommended: winding-up is too rigorous, reduction too expensive [5]); none of them at any rate would further the company's credit.

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[1]) *Modern Law Review*, vol. 4, p. 273, 289.

[2]) *Modern Law Review*, vol. 4, p. 285.

[3]) See however payment of "Bauzinse" (Art. 804/2 C.O.) corresponding to "payments of interest out of capital" (Sect. 65 of the Act) as regulating measure.

[4]) *Modern Law Review*, vol. 4, p. 295.

[5]) "Furthermore, it would enhance the costs of investment", *Modern Law Review*, vol. 4, p. 295.

Whereas the possibility of mobilizing capital may have a certain importance in the case of big concerns, it cannot be accepted without demur when it involves small businesses—as Private Companies are likely to be. There is, in our submission, hardly any need for mobility of capital, say in a family-business with a capital of £ 100. Obscure dealings moreover [1]) are not exceptional in this sphere of business life. One cannot help asking therefore whether the advantage of mobility of capital and flexible rules as to capital maintenance are worth the risks that are being run by the creditors. Their position is very vulnerable; they may sue the directors without success if the capital is lost. This example illustrates that the Lee-rule series of decisions was established on the basis of large-scale enterprises and that a special treatment for smaller concerns (like to-day's Private Exempt Companies) might be desirable de lege ferenda.

An erroneous picture of dividend policy would perhaps be obtained if we did not point out that in practice, where capital has been lost or is unrepresented by the assets available, the companies in the great majority of cases take steps to *reduce their capital*. The Courts never refused their consent [2]), being aware of the alternative offered by the Lee-rule and the provisions connected therewith.

Nevertheless, the Law does not cease at present to be permeated by the notion that the doctrine of irreductibility of capital is subordinate to the higher principle that the contributed capital is subservient to the purpose for which the company was called into existence [3]).

Cases arise repeatedly to which this more flexible conception established by the Lee Rule is being applied.

The English Courts have chosen the difficult task to conciliate the advantages of the nominal capital as a *guarantee fund* on one hand, and as being available, on the other hand, for *pouring out dividends* in some exceptional cases (to be determined by commercial experience). The Lee rule series of decisions is but the conscientious search for suitable criteria.

The great bulk of cases, however, excludes to a large extent a clear-cut and definite appearence of the rules obtained. Those continental lawyers are mistaken who do not accept the complexity of this most differentiated solution and believe that they can reduce it to a short formula [4]).

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[1]) Control is rendered even more difficult when "exempt" Private Companies (60% of all Private Companies are "exempt") are concerned, since they are released from filing accounts (Sect. 129, subs. 2 of the Act, 7th Schedule).

[2]) PALMER, *Company Law*, p. 204.

[3]) *Law Quarterly Review*, vol. 5 (1889), p. 221, in connection with critical remarks on the Lee Case.

[4]) Thus, in our submission, Prof. H. TRUMPLER in his book on "*Bilanz und Steuerrecht der Aktiengesellschaft nach englischem Recht*", pp. 95, 96, misunderstood somewhat the position of English dividend Law: he endeavours to explain it with the theory that all the dividend cases are in fact dealing with the problem of the *reserve capital* only, and not with that of the nominal capital. This would amount to say that only such dividends can be paid out of nominal capital as *reserves* are available to make good the resulting decrease.

OTHER RETURNS OF CAPITAL

Besides the payment of dividends out of capital assets there are still several other possibilities of return of capital which are prohibited by the Law, subject to certain exceptions.

We intend to demonstrate that the arguments put forward by different Judges at different periods can all be concentrated and that they lead back to the basic principle of capital maintenance, a breach of which would be "ultra vires" or illegal [1]).

§ 18. PAYMENT OF INTEREST OUT OF CAPITAL

I. According to Art. 804/2 C.O., *no payment of interest out of capital* is authorized [2]). This prohibition is as well established in the various continental Laws [3]) as it is in England. Taking into account the circumstances, such as the period of construction or development of an enterprise, the profits may be very small or even non-existant. Most of the Company Laws have therefore introduced an exception for payments of *interest for the time of construction* [4]). Art. 804 C.O. refers to Art. 676 C.O. concerning the Société Anonyme:

"Un intérêt d'un montant déterminé qui est porté au débit du compte d'installation, peut être prévu en faveur des actionnaires pour la période des travaux de préparation et de construction de l'entreprise; il cessera d'être payé dès l'exploitation normale de celle-ci. Les statuts indiqueront dans ces limites le montant à partir duquel le paiement des intérêts cessera."

It was apprehended that the participation in enterprises in the form of S.A. and S. à R. l. would decrease appreciably if the members of the company were expected to renounce possibly any dividend during that period, should the enterprise not yield any profit. The possibility of guaranteeing, especially to those who engaged the whole of their fortune, a regular income by means of a payment of "intérêts intercalaires" was deemed to be a social necessity [5]).

From the legal point of view however, the "intérêts intercalaires", already

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[1]) Compare Appendix III, p. 84.

[2]) That is to say, no payment of interest promised independently of a net profit. Should it not be possible to ascertain a net profit, this interest can be paid only out of capital assets. Consequently the rule of capital maintenance would be broken.

[3]) E.g. Swiss Société Anonyme, Art. 675/1 C.O.

[4]) "Bauzinsen"; "intérêts intercalaires".

[5]) The same result, however, can be achieved

a) through an agreement of guarantee of a dividend of a certain amount given by a third party (usually the State or any public corporation),

b) through the promise of preference shares, though such promise implies the presence of profits.

Compare in English Law the *Alexandra Palace Case* (1882), 21 Ch. D. 149, at p. 157, where such preferential dividend had been promised.

known in the Société Anonyme, were introduced only with serious hesitation [1]): one of the main questions was whether an exception to the rule that the capital may not be reduced, was to be allowed notwithstanding the principle of the creditors' protection which was intended to be particularly emphasized in this form of corporation. The interests of the members nevertheless prevailed over the need for capital maintenance and thus over the protection of the creditors. It is therefore erroneous to consider Swiss capital maintenance rules so rigidly applied when dividends are concerned—without keeping in mind that the "intérêts intercalaires", though limited in extent, purpose and time, represent an important exception to the principle that the capital cannot be reduced.

The payment of interest out of capital in time of construction was first authorized by the Companies Act, 1907 [2] [3]), in Sect. 91 (nowadays Sect. 65 of the Act, 1948) the substance of which is similar to Art. 676 C.O. in point of principle, except for the extensive powers of the Board of Trade which is to give—among other control powers—its approval to the articles or the special resolution concerned therewith:

Sect. 65:

"When the shares are issued for the purpose of raising money to defray the expenses of the construction of any works or buildings or the provisions of any plan which cannot be made profitable for a lengthened period, the company may pay out of capital interest on the share capital so issued... subject to the following conditions:

i) no such payment shall be made unless authorized by the articles or by a special resolution (a);
ii) the sanction of the Board of Trade must be obtained (subs. I b);
iii) the Board of Trade determines the period during which the payments are allowed (subs. I d)
iv) the maximum interest rate is 4% (subs. I e).

Section 65 also applies to Private Companies.

For the historical development which led to the state of the Law of 1907, most of the textbooks deal with the question very briefly—if at all—and, in our submission, in a rather misleading manner. Thus they proclaim that the capital maintenance rule had suffered no exceptions before the Companies Act, 1907; this is an inadequate assertion if we place the problem into its proper frame, that is to say, if we consider it—and we have to—in connection with the dividend policy developed in the nineties of the last century and inaugurated by the *Lee* v. *Neuchâtel Case* [4]). We are basing our opinion on the following argu-

[1]) The 3rd Draft and the Commission of Experts had preferred to prohibit "intérêts intercalaires", being influenced no doubt partly by the German Legislation which authorizes "Bauzinsen" only for the "Aktiengesellschaft" (HACHENBURG, "*Kommentar*" zu § 29, Anm. 12, as a consequence of § 30 of the Law). "Intérêts pour la période de construction" are provided in Art. 34 of the French Law. An account of the arguments in the Swiss controversy can be found in FANCONI, "*Die Haftung des Mitgliedes einer G.m.b.H.*", p. 58, 59.

[2]) Not the Act of 1929 (as apparently asserted in v. STEIGER, "*Aktienrecht*", p. 60).

[3]) Interest in time of construction could already be paid before the 1907 Act by companies incorporated under special Act of Parliament. On point of principle it was therefore not an innovation but an extention to the companies under the Act (HANSARD, [171] H.L., col. 166). Compare also Report of the Amendment Committee (1906), Cmd. 3052.

[4]) Compare, *supra*, § 15.

ments. The textbooks quote the *Alexandra Palace Case*[1]) which occupies indeed a key position in the questions of disallowed returns of capital; but it should be kept in mind that this case came before the Chancery Judges at a period when the principle that capital could not be reduced was still inviolable. A rapid glance at the arguments put forward in this case shows it clearly. Thus it was argued "that directors were at liberty to pay interest on money during the course of construction, if they could not raise the money except on these terms; otherwise they could not carry on their undertakings"[2]); but FRY, J., who gave the judgement, did not agree with this view. Therefore, still adhering to the generally accepted view, he called such argument "a subterfuge by which it is attempted to return capital to shareholders and thereby to diminish their liability, which ought not be countenanced for one moment by this Court". "The amount having been directly or circuitously abstracted from the assets of the company", he applied the "ultra vires" doctrine in the same way as practised in the contemporary dividend cases.

Then in 1889 came the *Lee Case*. It is to be remarked that the series of cases based upon it are for a good part concerned with returns in time of construction where the company erected works which could not be productive until completed. A comparison between Lord LINDLEY's instance given in the *Lee Case* and another example by Hamilton given in connection with interest demonstrates that exactly the same problems are involved[3]). Now, the Lee rule brought *one way of evasion* enabling the companies to pay dividends under condition well-

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[1]) *Alexandra Palace Case* (1882), 21 Ch.D. 149, especially p. 156 et seq. The facts were the following: the articles of association of a company provided that all dividends on shares should be made only out of the clear profits of the company and that all moneys borrowed by the company and all moneys received under insurances of the company's property against destruction or damage by fire should be deemed capital. A building of the company having been destroyed by the fire, the company resolved to increase the capital by £ 150 000 for the purpose of reconstructing the building, and to issue for this purpose 15 000 preference shares. These shares were issued, and during the reconstruction of the building, no profits having been earned by the company, the directors paid four dividends on the shares. The first dividend was paid out of the moneys received from an insurance company in respect of the loss occasioned by the fire; the other three dividends were paid by means of moneys borrowed expressly for the purpose from the contractors of the company and a financial company, both of whom had notice of the purpose for which the money was borrowed, and both of whom held a large number of the preference shares.

[2]) *Alexandra Palace Case*, *supra*, at p. 166. This opinion, in other words, points already to Lord LINDLEY's statement, 7 years later in the *Lee Case*, that the irreductibility of capital would "paralyse the Law of the country".

[3]) *Lee* v. *Neuchâtel Asphalte Co.* (1889), 41 Ch.D. 1 at p. 22: "... suppose a company is formed to start a daily newspaper; supposing it sinks £ 250 000 before the receipts from sales and advertisements equal the current expenses, and supposing it then goes on, is it to be said that the company must come to a stop, or that it cannot divide profits until it has replaced its £ 250 000 which has been sunk in building up a property which if put up for sale would perhaps not yield £ 250 000?" HAMILTON, *Company Law* (1910), p. 317: "... suppose a limited company is formed to construct a foreign railway, and the contract price for the construction of the railway is to be paid in cash, which is to be raised by the issue of shares and debentures. Then, until the railway or part of it is completed it can earn no revenue and consequently dividends upon the shares and interest on the debentures, if paid at all, must be paid out of capital..."

known to us from our discussion in a preceding chapter, even if the nominal capital is truly reduced to a certain extent. However, as far as *interest* is concerned, no change intervened and even the judgement given after the *Lee Case* in *Re Sharpe* [1]) by LINDLEY, L. J. (who himself had given the principal judgement in the *Lee Case*), remained throughout on the ground of orthodox conceptions. We must however concede that this case was decided at the period when *Lubbock* v. *British Bank* [2]) was to restrict momentarily the application of the *Lee* rule to companies formed to work a *wasting property*. These temporary trends may have influenced the decision in *Re Sharpe*. Considering these two cases in their historical and material relation to other aspects of Company Law, the textbooks, when concerned with interest paid out of capital, would have been able to realise that a solution had been given in the field of dividend policy by the Lee rule series of cases, the necessity of which had precisely been recognized in connection with the period of construction.

Dividend policy and the question of interest out of capital are closely interrelated on an economic level: the intransigency of the *Alexandra Palace* and the *Sharpe Case* had a counterpart in the *Lee rule* series which enables the directors to provide for a good part of the legitimate financial interests of the shareholder in time of construction.

Sect. 9 of the Act of 1907 [3]) nonetheless has created some *advantages* which could not be obtained through dividend policy:

i) The possibility of payment of interest according to Sect. 65 represents an income declared in advance and guaranteed to the prospective member for a defined period and a certain amount, independently of profits available. This is an important security for a member of modest means who intends to engage his small fortune in an enterprise and who therefore depends fully or partly on its yield for his income.

ii) The numerous control provisions should render abuses more difficult and give to the *creditors* some guarantee that the reduction of capital through payment of interest is kept within the conditions of Sect. 65 and will not jeopardize their interests.

These are the principal advantages of the Act of 1907 in that respect; they are not as overwhelming as PALMER [4]) asserts. Did the prohibition of payment of interest really cause "great inconvenience" [4]) if we take into account that an adaptation to the needs in periods of construction was possible through the new dividend policy introduced in 1889 by the *Lee Case*? We do not think so. A glance at the *Reports of the Board of Trade* shows that applications under Sect. 65 are extremely rare (varying between 0 and 3 every year!; see the figures of 1921 to 1931 for instance). The section seems therefore to be a *dead letter*.

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[1]) *Re Sharpe*, [1892] 1 Ch. 154.
[2]) *Lubbock* v. *British Bank of South America*, [1892] 2 Ch. 198; compare § 15.
[3]) Sect. 65, *Companies Act*, 1948.
[4]) PALMER, *Company Law*, p. 208.

For the Continental Laws, however, the payment of "intérêts intercalaires"—inasmuch as it has been authorized—occupies a *much more important function* in the legal construction of the company, since the dividend rules, in contradistinction to the English ones, are rigid [1]) and do not allow besides the "interêts intercalaires" any other general exception to the principle of irreductibility corresponding to the *Lee rule*. On the contrary, in England, when interest in time of construction has not been stipulated according to the provisions of Sect. 65, the possibility of paying dividends, subject to the frame of English dividend policy, still remains available.

Apart from the payment of interest in time of construction there are two more exceptions to the general rule. One is connected with the British Empire and concerns a provision of the Indian Railways' Act, 1894. The other exception is made both in English and Swiss Law in case of *payments of calls in advance;* interest may then be paid out of capital [2]).

II. The question of *interest* to be paid for *moneys borrowed* for the construction, independently of an issue of shares, is not always clearly distinguished from "interest" or "dividends" paid out of capital [3]). Although there was at one time some hesitation in English Law [4]), the directors are entitled to treat the interest on the loans as a capital charge, which need therefore not be made good out of profits before any dividends could be paid on the share capital [5]). The reason is that the buildings or works, once completed, represent not only the moneys expended on them, but also any interest that has been paid to raise such money. The further argument, however, that such interest can be charged to capital account, whenever it is usual for individual traders [6]) to do so, is not convincing, having regard to the fact that the liability of an individual trader is not limited and that he is therefore not compelled to possess an intact capital in exchange for the privilege of limited liability.

In Swiss Law interest for borrowed moneys and "versements supplémentaires" are also allowed [7]).

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[1]) Compare § 13.

[2]) Sect. 59 of the Act mentioned. *Lock* v. *Queensland Investment and Land-Mortgage Co.*, [1896] 1 Ch. 397, affirmed [1896] A.C. 461 (H.L.). JANGGEN-BECKER, *Commentary,* Art. 804 C.O., No. 14, al. 2.

[3]) So in *Bardwell* v. *Sheffield Waterworks Co.* (1872), L.R. 14, Eq. 517, where the terms interest and dividends on loans and shares seem to be treated without discrimination. Also *Alexandra Palace Case,* where the term "dividends" is always used for "interest". The clear distinction is drawn by STIEBEL, *op. cit.,* p. 363, 364; HAMILTON, *op. cit.,* p. 317.

[4]) Compare *Bloxham* v. *Metropolitan Railway Co.,* L.R. 3 Ch. 337, where it was held that it is "doubtful" whether interest on debentures could be charged to capital.

[5]) *Bardwell* v. *Sheffield Waterworks Co., supra; Hindes* v. *Buenos Ayres Grand National Tramways Co.,* [1906] 2 Ch. 654, where the *Bardwell Case* is referred to, at p. 660.

[6]) STIEBEL, *op. cit.,* p. 363, 364; vide the *Alexandra Palace Case, supra,* (where *McDougall* v. *Gardiner* (1875), 1 Ch. 728 is quoted).

[7]) JANGGEN-BECKER, *Commentary,* Art. 804 C.O., N. 14, al. 2.

§ 19. THE PURCHASE BY THE COMPANY OF ITS OWN SHARES

The purchase by the company of its own shares ("parts sociales") is prohibited by Art. 807 of the Swiss Law except on condition that the shares are fully paid up and that the purchase price is paid out of a "surplus" of assets so as to keep intact the nominal capital. This exception makes it possible for a member who intends to leave the company to do so although no new member is to succeed to him. The individual character of the Swiss S. à R. l. thus is taken into consideration. Whether Art. 807 C.O. contains a compulsory or only a directory rule ("Ordnungsvorschrift") is a matter of some controversy. The opinion of the Swiss Commentator [1]) who inclines to adopt the latter conception can hardly be accepted with regard to contracts where the purchase price is paid out of nominal capital, since it represents a disallowed return of it. The argument that the parties may be held liable in damages at any rate, according to Art. 827 C.O., is in contradiction with the nature of the system of liability in the S. à R. l. which is expected to provide for protection independently of the rules in Art. 827 C.O.[2]).

In English Law the purchase by the company of its own shares without the consent of the Court is illegal and therefore *void;* it involves a return of capital to the shareholders and thus a reduction of capital in conflict both with the capital maintenance rule and Sect. 66 of the Act [3]). This is the basic principle. That a company "cannot be member of itself" and must not be entered into the share register as a shareholder [4]) are only consequences of the principle described.

No transaction can be justified as "incidental" to the objects of the company where it is desired to concentrate the shares in the hands of a few [5]), although such a possibility may be desirable precisely in a Private Company (as has been taken into consideration in Art. 807/2 of the Swiss Law). It goes without saying that the acquisition by the company of its own shares is valid in the case of *unlimited* companies [6]).

In order to prevent any evasion of the prohibition described above and with the view "to prohibit the companies from trafficking in their own shares—a practice which was open to gravest abuses" [7]), Sect. 54 of the Act, 1948, was introduced in 1929 (Sect. 45 of the Act, 1929). This section aims at the *prohibition*

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[1]) Janggen-Becker, *Commentary,* Art. 807 C.O., N. 1.

[2]) Compare below § 22, III.

For the validity of the purchase, compare BGE 60 II 319; O. K. Kaufmann, "*Die Haftungsverhältnisse in der schweizerischen G.m.b.H.*", p. 128 et seq.; for the Société Anonyme see W. Schmid, *op. cit.,* p. 134 et seq. and for the conception of a directory rule, A. Siegwart, "*Kommentar zum ZGB*", vol. 5, part 4–5, "*Die Aktiengesellschaft*", Art. 659 C.O., N. 21, 22.

[3]) *Trevor* v. *Whitworth* (1887), 12 App. Cas. 409.

[4]) Charlesworth, *Company Law,* p. 69; Buckley, *op. cit.,* p. 135.

[5]) Buckley, *op. cit.,* p. 135.

[6]) Palmer, *Company Law and Precedents,* p. 365.

[7]) In Re *V.G.M. Holdings Limited,* [1942] Ch. 235.

of financial assistance by the company to members for the purchase or the subscription of its own shares [1]); but Sect. 54 itself provides for some exceptions to the rule. From the comparative point of view the most interesting of these concerns loans which can be given under certain conditions by the company for the purchase of *fully paid up shares* (compare Art. 807 of the Swiss Law) [2]). From the provisions related with the *protection of minorities* comes one more exception. Accordingly, a company may purchase its own shares under order by the Court (Sect. 210).

§ 20. ISSUE OF SHARES AT A DISCOUNT

It is illegal to make a present of bonus shares [3]) or to *issue shares at a discount*, that is to say, to allot fully paid up shares on payment—in cash or in kind—of less than the nominal value of such shares. From the investor's standpoint the dominant principle is that he shall "purchase immunity from liability beyond a certain limit on the terms that there shall remain a liability up to that limit", as said Lord MACNAGHTEN in *Ooregum Gold Mining Co. of India* v. *Roper* [4]). As for the company, the rule is that it is compelled to possess the capital "which the legislature has enjoined shall be the capital upon which it is to trade" [5]).

Hence the company is not allowed to evade this obligation by any direct or indirect agreement to pay a sum lesser than the amount subscribed for. Lord MACNAGHTEN's argument points to the further function of the prohibition of issues at discount in connection with the raising of capital and the mechanism of the limited liability of the shareholder.

Nevertheless, the issue of shares at a discount has been allowed by the Act of 1929, subject to the sanction of the Court and other conditions, such as a resolution in general meeting, the specification of a maximum rate and a minimum of 1 year to have elapsed from the commencement of business. The provisions are to be found in Sect. 57 of the Act of 1948 (subs. (3) thereof does not apply to Private Companies) and 6th Schedule § 3 (g), 8th Schedule § 3 (e). Applications do not seem to be frequent [6]).

It should be noted that the payment of *underwriting commission*, which power

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[1]) *Victor Battery Co.* v. *Curry's Ltd.*, [1946] Ch. 242; "or subscription" has been added in the Act of 1948; compare also in *Re V.G.M. Holdings Limited, supra.* Sect. 45 (I) of the Act, 1929, did not cover a transaction by which a company provides money to assist a subscription for its own shares.

[2]) Furthermore a voluntary transfer of fully paid up shares to a trustee for the company itself is possible (*Kirby* v. *Wilkins*, [1929] 2 Ch. 444).

[3]) In Re *Eddystone Marine Insurance Co.*, [1893] 3 Ch. 9 (C.A.).

[4]) *Ooregum Gold Mining Co. of India* v. *Roper*, [1892] A.C. 125, at p. 145; per Lord HALSBURY L.C., at p. 133.

[5]) Per Lord HALSBURY L.C., in *Randt Gold Mining Co.* v. *New Balkis Eersteling*, [1903] 1 K.B. 461, at p. 465.

[6]) PALMER, *Company Law*, p. 52; Re *Derham & Allen*, [1946] Ch. 31. Compare also: issues at a discount before the Act of 1929; *Ooregum Gold Mining Co. of India* v. *Roper, supra; Welton* v. *Saffery*, [1897] A.C. 299.

the Private Companies have also enjoyed since the Act of 1900 [1]), is in effect an issue of shares at a discount. The financial result is also the same in case of allotment of shares for a consideration other than cash with inadequate valuation [2]).

§ 21. THE RELEASE OF THE LIABILITY TO PAY FOR CALLS

The *release of the liability to pay for calls* is closely related to the allotment of shares at a discount; the principles applied are the same. In *Re White Star Line* [3]) CLAUSON, L. J., referred to a statement of LINDLEY, L. J., in *Re Wragg* [3]). According to this case, the obligation of the shareholders to pay the nominal amount in full can be satisfied by any transaction "which amounted to accord and satisfaction or *set-off* as distinguished from payment in cash", subject, however, to the *limited capacity* of the company introduced by the "ultra vires" doctrine. A Limited Company thus having no capacity to release a shareholder from his obligation to pay up his shares without obtaining payment in cash or in kind, the conclusion was arrived at that a contributory who is also a creditor of the company, is *not entitled to set off against calls*. An early case [4]) had already established this unquestioned practical solution.

To the issue of shares at a discount corresponds in *Swiss Law* the issue of shares against payment of an amount less than the nominal value, called "émission à un cours inférieur au pair", which is impliedly prohibited by Art. 774 and 802/2 C.O.[5]). The same applies to French Law, otherwise the capital would never be entirely paid up [6]).

A release of the liability to pay for calls is expressly prohibited in Art. 798/2 of the Swiss Law.

PART 3

REDRESS PROVISIONS IN CASE OF DISALLOWED RETURNS

Having now set up the catalogue of the various aspects of disallowed returns we have finally to analyse the corresponding remedial provisions. Who is liable to refund the moneys paid out of capital and who is entitled to claim such restitution?

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[1]) PALMER, *Company Law and Precedents,* p. 159; compare also *Dominion of Canada General Trading and Investment Syndicate* v. *Brigstoke,* [1911] 2 K.B. 648; *Report* of the Company Law Amendment Committee, *supra; Solicitor's Journal* (1906), p. 608.

[2]) Compare §§ 11–12 on payments "in kind".

[3]) Re *White Star Line,* [1938] Ch. 458, at p. 476; *Re Wragg,* [1897] 1 Ch. 796, at p. 826 and 829.

[4]) *Grissel's Case* (1866), L.R. 1 Ch. App. 528; STIEBEL, *op. cit.,* p. 1044; BUCKLEY, *op. cit.,* p. 542.

[5]) "Unterpariemission"; JANGGEN-BECKER, *op. cit.,* Art. 774 N. 11; *explicitely* prohibited in the S.A. provisions (Art. 624/1 C.O.).

Compare §§ 11–12 on payments for a consideration other than in cash, which are closely connected with issues at a discount.

[6]) J. ESCARRA, in *Cambridge Law Journal,* vol. 11, p. 17.

§ 22. THE PROVISIONS OF THE SWISS CODE

The provisions of the Swiss Code will be dealt with briefly, having regard to the aim of our analysis. On points of controversy, however, reference will be given of some dissentient authors.

Different provisions exist for the restitution of disallowed dividend (I) and the restitution in case of other returns (II). Mention of further important remedies is made under (III) and (IV).

I. Liability in case of disallowed payment of dividends

With regard to the restitution of disallowed dividends, the liability of the member in the S. à R. l. is based on the system known in the Société Anonyme although it is not completely similar. In the Société Anonyme the member (or the director) has not only to replace the "unlawful enrichment" ("enrichissement illégitime"), but the full amount received during the 5 years following the payment. If, however, he succeeds in proving that he received the money bona fide he need not refund it at all (Art. 678 C. O.). Furthermore, in case of bankruptcy the directors are liable to replace all the disallowed returns they have received during the 3 years preceding the declaration of bankruptcy (Art. 679 C. O.).

As to the provisions *for the S. à R. l.*, the members and directors are also compelled to replace on a claim the disallowed dividends they received for the 5 next years following the payment (Art. 806 C. O.); but as against the provisions of the S. A., the *bona fide recipient* of dividends *cannot escape liability* to refund during the 2 years following the payment [1]). His liability is however limited to the amount corresponding to the creditors' claims (Art. 806, 2 C. O., also § 31 al. 2 of the German Law). This stronger liability of the bona fide member was introduced in view of the fact that he has more opportunity than the members of a Société Anonyme to control the management of the company in which he usually takes part [2]). Consequently he does not require as strong a protection as the former. A further reason can be found in the fact that the principle of capital maintenance has been more emphasized in the case of the S. à R. l. than in that of the Société Anonyme (Art. 802 C. O.).

Through the limitation of time within which proceedings must be instituted it is intended to answer a legitimate need of the members to dispose of the moneys without the danger of a subsequent action, after a reasonable amount of time

[1]) French Law makes no difference between bona and mala fide recipient (Art. 35 of the "Loi du 7 mars 1925"). This creates in our submission unnecessary hardship for the bona fide recipient, although it seems to be adequate that he should not be completely released, since he has more facilities for enquiring about the company's management than the member of the Société Anonyme.

[2]) "Bulletin sténographique du Conseil National", 1934, p. 745.

has elapsed. The claim has to be brought in by the *Company*, and *no creditor* is entitled to do so on the footing of Art. 806 C.O.[1]).

II. Extent of the privilege in Art. 806/2 and 3

Whether the privilege of Art. 806/2 and 3 (for bona fide recipients: the limitation of liability to the amount necessary for satisfying the creditors' claims, and the limitation of actions to 2 years; for mala fide recipients: limitation of actions to 5 years) which is explicitly conferred upon recipients of disallowed dividends only, should also be applied to payments of interest and to the *other returns described above*, is controversial in Swiss Law. It is not proposed to examine in detail the multifarious opinions in the matter, but a few considerations are indispensable for our purposes of comparison.

1. Considering that the Legislator when setting out the rules for the S. à R. l. has constantly and primarily paid attention to the protection of the creditors, we take the view that Art. 806 C.O. should not be interpreted extensively and must be therefore restricted to the recipients of disallowed dividends only.

2. Another argument supporting our view has been given by KAUFMANN[2]): wilful returns of capital—as opposed to payment of disallowed dividends—are a much more serious encroachment upon the creditors' rights. There is therefore no reason for extending the privilege to them[3]).

3. FANCONI[4]) admits a uniform treatment for *all kinds of returns* having regard on one hand, to Art. 802/2 C.O. (dealing with the *external* liability) where the returns (dividends, interest and other returns) are set out without distinction of treatment and, on the other hand, to the fact that these returns are moreover altogether breaches of the capital maintenance rule. FANCONI, however, seems to forget that the common base of capital maintenance does not exclude varia-

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[1]) However, according to the provisions enacting the external liability of the members embodied in Art. 802 C.O., the creditors (so the liquidators claim on their behalf) are entitled to recover (see *infra*, sub. IV). In French Law the creditors are entitled to sue the recipient on Art. 35 of the "Loi du 7 mars 1925" corresponding to Art. 806 of the Swiss Law.

[2]) *op. cit.*, p. 39.

[3]) *Quaere*, whether the reference in Art. 804/2 C.O. to the S.A. provisions concerning the "intérêts intercalaires" also involves Art. 678, as KAUFMANN (*op. cit.*, p. 139) seems to take it for granted. In our submission, the reference is limited to Art. 676 which deals with nature and extent of the "intérêts intercalaires" ("Ausrichtung" as the term in Art. 804/2 C.O. runs); Art. 678 C.O. belongs to the S.A.'s own system of liability; it is a commonplace that the Legislator of the S. à R. l. has been less generous with the privileges of the members; hence the different treatment as regards the S. à R. l. seems to be deliberate. The bona fide recipient, therefore, will not benefit from the exemption to return the disallowed "intérêts intercalaires" according to the S.A. provision (Art. 678 C.O.). The same result is obtained by A. EDELMANN, "*Der unberechtigte Empfang von Zinsen und Gewinnanteilen bei der A.G. und der G.m.b.H.*", p. 41, although his argumentation is not convincing.

The period of limitation set out in this same Art. 678/2 and fixed at 5 years would practically not be altered since we adopt the view that the same period applies because of the periodical nature of returns in form of "intérêts intercalaires" (see *infra*, sub. 4).

[4]) A. FANCONI, "*Die Haftung eines Mitgliedes einer G.m.b.H.*", p. 65 et seq.

tions and different degrees in the consequences of the various returns, if we agree that the most serious breaches of the capital maintenance rule are occasioned by wilful returns and not by payment of disallowed dividends [1]).

4. What are then the *periods of limitation* to be applied to returns other than dividends? With regard to the arguments given above, we cannot agree with the Swiss Commentary [2]) applying to them the rules of "unlawful enrichment" ("enrichissement illégitime"), Art. 62 et seq. C.O., which would mean a reduction of the time limit for bringing an action to one year since notice of the illegality of the return and ten years since its payment by the Company to the recipient.

We prefer to follow the opinion of Kaufmann [3]) which seems to be the most adequate. Thus, according to a principle of general Law (Art. 128 C.O.) the period of limitation in case of *periodical returns* is 5 years (interest out of capital) and in case of other returns 10 years [4]).

The analysis made hitherto leads us to sum up the limitation provisions as follows:

i) 2 years for the bona fide recipients of disallowed dividends (moreover limitation, as regards the amount, to a sum corresponding to the creditor's claim);

ii) 5 years
   a) for the mala fide recipients of disallowed dividends (no limitation of amount, subject to the limitation according to Art. 802 C.O.),
   b) in case of interest and "intérêts intercalaires";

iii) 10 years in case of *other returns*.

III. Responsibility of the directors

Disallowed returns of any kind are always the result of malpractices or misapplications by the managing directors ("gérants"). Hence, beside the special provision of Art. 806 C.O., an action can always be brought on the ground of the *responsibility of the directors* (Art. 827 C.O.) [5]) which is independent of the bona or mala fides of the recipients of disallowed returns. Negligence on the part of the directors is, however, a condition [6]). The burden of proof never rests upon the plaintiff: he need merely show that the directors have not performed their duty and that damages to the Company have resulted in consequence. The burden of proof that they were not negligent falls upon the directors. Every shareholder has a personal claim independently and in concurrence with the Company (Art. 754

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[1]) A.T.F. 60 II 27; 61 II 255; to vary the extent of liability is a matter of consequence.

[2]) JANGGEN-BECKER, *op. cit.*, Art. 806 N. 1.

[3]) *op. cit.*, p. 140.

[4]) Compare KAUFMANN, *op. cit.*, p. 139, with an audacious but, in our submission, accurate argumentation.

[5]) This Art. 827 C.O. refers to the provisions of the Société Anonyme (Art. 754 et seq.) which do apply, without restriction; an invitation to the public not being prohibited—in contradistinction to English Law—liability for misrepresentation in prospectuses is also provided for: compare § 2, p. 11.

[6]) Any form of negligence.

C.O.); thus he need not wait and see whether the company will take any action. Moreover the *creditor* can also claim damages *subject, however, to the Company being wound up voluntarily or by the Court* (Art. 758 C.O.).

In consequence of the Company's nature as a corporate body, a difference is drawn between damages caused directly to the Company, being *mediate* damages to the members' shareholding, and damages caused directly to the members (*immediate* damages). In the first case the claim can be brought by the shareholders with a view to obtain a refund of the disallowed returns to the *Company only*.

The limitation of the claim is set out in Art. 760 C.O.:

i) 5 years since notice of the damage and of the person who occasioned it;
ii) 10 years (absolutely) from the day of the damaging act;
iii) in case of penal proceedings not before the limitation period according to penal Law has elapsed.

This system of responsibility of the directors does provide for a proper amount of security, at least when big enterprises are concerned, inasmuch as the directors do not or at least do not mainly participate in the shareholding and are therefore able to take an intermediate position between shareholders and creditors. Experience however has shown that shareholding and management being usually united in *smaller concerns*, the directors' interests are—to a certain extent—shifted from the care for prosperity of the business to yields of big dividends [1]). Thus any control of the management through the shareholders is suppressed to the detriment of the *creditors* who were able—in the big concerns described—to benefit indirectly from the shareholders' vigilance. Private and company accounts and moneys being moreoververy often mixed, when a small business is concerned, the circumstances are so impenetrable and interwoven from the point of view of an outsider that it is often difficult to produce evidence of omissions and fraudulent dealings.

IV. The liability of the members according to Art. 802 C.O.

Having regard to that experience made with small businesses, the Legislator's intention was to give a further remedy *independently* of the system of responsibility laid down in Art. 827/754 C.O. This remedy has been enacted in Art. 802 C.O. It represents the crucial point of the system of liability in the Swiss S. à R. l.; the members are jointly and directly liable for capital which has not been paid up or has been returned [2]) to the members. The liability is limited both to the creditor's claims and to the amount of the nominal capital [3]).

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[1]) Compare KAUFMANN, *op. cit.*, p. 46.
[2]) For instance any disallowed return.
[3]) An account of the minute particulars of the system of liability in Art. 802 C.O., which are not of direct interest for our purposes of comparison, can be found, among others, in KAUFMANN, *op. cit.*, chapters 3–8.

§ 23. THE PROVISIONS OF ENGLISH LAW

In English Law, only very few provisions as to the modus of refunding the returns have been enacted. The rules have therefore to be gleaned from the cases and are not numerous either. The most complete set of rules is to be found in respect to disallowed payment of dividends, with which we shall deal first (I). In the second place, we intend to determine on the base of these rules whether the treatment regarding returns other than of dividends has to be modified in some respect (II).

I. Provisions as to disallowed payment of dividends

1. It must be distinguished beforehand between payments of dividends deemed to be "intra vires" and those "ultra vires" the Company. The former have been sometimes called "improper" payments [1]). Thus, when the Court held that the payments kept within the principles and frame of a valid dividend policy, the directors who in good faith agreed to the payment out of capital are not liable to refund it [2]). If the company has approved the payments in general meeting, with full knowledge of all the facts, the company cannot recover the moneys so paid [3]). Here, however, we are concerned with the consequences of illegal or "ultra vires" payments of dividends. The difference is that as soon as the conclusion is arrived at that the Company's money has been applied by the directors to purposes which the Company cannot sanction, the directors are liable to replace the money, however honestly they may have acted [4]). No explicit distinction is made in *Swiss Law*, although it provides impliedly for different consequences in case of payments contrary to the articles ("improper" payments) as opposed to the case of *illegal* payments, where the rules as to disallowed returns apply. A payment in breach of the articles can only be recovered by the Company according to the principles of "unlawful enrichment" ("enrichissement illégitime"), Art. 63 C.O.[5]).

2. As in the Swiss Société Anonyme, the *bona fide* recipient of a dividend paid out of capital is not liable to refund it [6]). This is a common case, for where disallowed dividends have been paid, the members are in most cases easily able to prove that they were deluded by fraudulent accounts, since they are not bound to investigate when the directors represent that profits have been made. No difference of treatment is made between the Public and the Private Company

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[1]) Although it is very often used for both kinds of payments (see e.g. STIEBEL, *op. cit.*, p. 37).

[2]) *In Re National Bank of Wales,* [1899] 2 Ch. 629, at pp. 630, 669, where the apparent contradiction to *Re Sharpe,* [1892] 1 Ch. 154, is discussed; PALMER, *Company Law and Precedents,* p. 637.

[3]) *Ammonia Soda Co.* v. *Chamberlain,* [1918] 1 Ch. 266.

[4]) Per LINDLEY, L. J., in *Re Sharpe, Re Bennett, Masonic and General Life Assurance Co.* v. *Sharpe,* [1892] 1 Ch. 154.

[5]) Compare KAUFMANN, *op. cit.*, pp. 137, 138. Explicitely distinguished in German Law §§ 30, 32.

[6]) *Flitcroft's Case* (1882), 21 Ch. D., p. 519; *Re Denham & Co.* (1884), 25 Ch. D., p. 752; PALMER, *op. cit.*, p. 637.

notwithstanding the more numerous opportunities for the member to control the Private Company's management with which he usually is more closely connected.

However, if the shareholder knows that he was receiving disallowed dividend payments, he is not allowed to keep them. The theoretical foundation of that rule is that the assets of a company are regarded as a *trust fund*. The money of the company is therefore applicable only to the special purposes of the company to be carried out by the agents (e.g. the directors) of the Company, and it is in that sense a trust fund applicable by the directors to those special purposes. Hence a person taking it from them, with notice that it is being applied to other purposes, cannot say that he is not a constructive trustee [1]). Although we agree with the view that such cases of mala fide recipients are likely to be rare, for the shareholders normally have only such information as regards profits as the directors supply, we submit that these mala fide cases are likely to be more frequent in small concerns such as a Private Company, where personal contact is closer and control easier.

3. Upon examination of the English rules concerning the *responsibility of the directors* corresponding to Art. 755 C.O. of the Swiss Law, it appears that their liability follows—as the stock phrase runs—from their quality of "trustees" [2]) of the Company's money and property and from the powers entrusted to them. Hence a misapplication of the Company's funds through payment of dividends out of capital is treated as a *breach of trust* on the part of the directors: they are jointly and severally liable to refund the amount with interest [3]). Moreover they will always be *primarily* ordered to make good the amount paid away. In the sequel however, they may themselves, subject to their acting fraudulently, endeavour to recover from each person who, at the date of the payment, had full knowledge of all facts. It should be emphasized that this does not modify in any respect their primary liability [4]).

As compared with Swiss Law, where negligence is a condition for rendering the directors liable, the responsibility of English directors is extremely heavy, since they are—in case of "ultra vires" returns—liable to replace the money *however honestly* they may have acted [5]). One alleviation however is given by the

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[1]) In the words of JESSEL, M.R., in *Russel* v. *Wakefield Waterworks Co.* (1875), L.R. 20 Et. 474 at p. 479; as to "Constructive trustees", compare SNELL's *Principles of Equity*, p. 131 et seq., especially: Receipt of Trust Property by Stranger to Trust, at p. 137.

[2]) We have of course to be aware of the fundamental distinction between a trustee of property and a director (*Smith* v. *Anderson* (1880), 15 Ch D. 247 C.A.); but for the range of questions of liability with which we are concerned the analogy is at least fairly accurate. More cautiously: "fiduciary relationship" (per ROMER, J., in *Re City Equitable Fire Insurance Co.*, [1925] Ch. 407, at p. 426).

[3]) *Flitcroft's Case, supra;* in *Re Alexandra Palace* (1882), 21 Ch.D. 149. The directors may be sued not only for what they paid to themselves, but for the whole amount actually paid out of capital. PALMER, *op. cit.*, p. 637.

[4]) In *Re Sharpe, supra,* per LINDLEY, L. J., at pp. 165, 166; in *Re Alexandra Palace, supra,* at p. 149; *Moxham* v. *Grant,* [1900] 1 Q.B. 88; PALMER, *op. cit.*, p. 637; STIEBEL, *op. cit.*, pp. 81, 82.

[5]) In *Re Sharpe, supra.*

Statute Book in Section 448 of the Act. The Court may grant relief either wholly or partly where the directors have acted "honestly and reasonably" and, with regard to all circumstances, "ought fairly to be excused". The Courts appear to use this statutory relief only in exceptional cases [1]).

4. Disallowed payments of dividends are to be restrained on an action brought by a shareholder, but neither by a creditor, nor by a debenture stockholder alleging the diminishing of the fund guaranteeing the payment of his debt [2]). As long as dividends are paid on the representation of the directors that they are paid out of profit, the shareholders are not precluded from taking proceedings. A shareholder, however, who took the dividend with full knowledge that the dividend was paid out of capital, cannot keep it and at the same time sue the directors to compel them to refund [3]); but this would not exclude the possibility, even at the instance of a single shareholder, of obtaining an *injunction* to restrain the future payment of dividends out of capital or other illegal acts in the future [4]). A "mere simple" contract creditor, however, would be precluded from obtaining such an injunction (on the ground that the fund for payment of his debt would be diminished) [5]). Nevertheless it would seem that there may be cases in which a creditor would have a locus standi [6]) and, if he is not paid in due course, he can ask for a winding up order and make the directors liable through the medium of the liquidators representing the creditors for the breach of trust [7]).

5. In the absence of fraud a claim against the directors may be barred by Sect. 19 of the Limitation Act, 1939 [8]). Moreover, independently of the statutory limitation, a "Court of Equity" refuses its aid to *stale demands*, where a party has slept upon his right and acquiesced for a great length of time [9]). There does not seem to be a generous use of this maxim in Company Law [10]).

II. Provisions as to other returns of capital

As we have already pointed out, the rules concerned with the refunding of returns other than dividends, are not as complete as those in case of disallowed

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[1]) *Re City of London Insurance Co.*, [1925] 41 T.L.R. 521.

[2]) *Hoole* v. *Great Western Railway Co.* (1867), 3 Ch. App. 262; *Mills* v. *Northern Railway of Buenos Ayres Co.* (1870), 5 Ch. App. 621; *Lawrence* v. *West Somerset Mineral Rail. Co.*, [1918] 2 Ch. 250; BUCKLEY, *op. cit.*, p. 907.

[3]) *Towers* v. *African Tug Co.*, [1904] 1 Ch. 558.

[4]) *Mosely* v. *Koffyfontein Mines Ltd.*, [1911] 1 Ch. 73; on appeal [1911] A.C. 409. TOPHAM, *Company Law*, p. 135.

[5]) *MacDougall* v. *Gardiner* (1875), 1 Ch.D. 13; *Guinness* v. *Land Corporation of Ireland* (1882), 22 Ch.C. 349; *Davison* v. *Gillies* (1879), 16 Ch.D. 347; *Bloxham* v. *Metropolitan Railway Co.* (1868), 3 Ch. App. 337; BUCKLEY, *op. cit.*, p. 907.

[6]) *Flitcroft's Case, supra*, p. 533.

[7]) *Re Sharpe, supra.*

[8]) 2 & 3 Geo. 6, c. 21.

[9]) Per Lord CAMDEN in *Smith* v. *Clay* (1767), 3 Bro. CC 639 at p. 640; this equitable remedy is called "Laches": compare SNELL's *Equity*, p. 17.

[10]) Applied in *Re Mammoth Copperopolis of Utah* (1880), 56 L. J. (Ch.) 11; dismissed in *Re Alexandra Palace* (1882), 21 Ch.D. 149, at p. 162.

dividends; but the few cases dealing with such questions are solved on a similar line.

We have not found any authority for a different treatment of the shareholders' liability in the various categories of returns according to the distinction made in Swiss Law. Furthermore, the primary liability of the directors, which follows from the general principle of their function as trustees [1]) remains of course unchanged.

After these introductory remarks, only a few more problems have to be treated, which are raised in connection with secondary consequences of some returns not involved in the divided refunding rules.

1. In case of purchase by the company of its own shares, it is to be remarked that the member who has sold his shares to the company is also liable to be *restored to the register*, since he never has validly disposed of his shares.

Some mention must be made of the contravention of Sect. 54 of the Act (prohibiting financial assistance for the purchase of the company's own shares). The Company and every officer in default is *punishable by fine*. As the Law stands to-day, although a breach of Sect. 54 is unlawful, it does *not invalidate* the contract between the vendor and the purchaser [2]). Thus, surprisingly, there is only a *criminal sanction* (the fine) but not a civil one. The commentators however agree that the *Victor Battery* decision should be reversed so as to declare *void* the unlawful contract. It should be made unlawful not only to *give* such security, but the *security itself*, if given, should be illegal [3]). Roxburgh, J., however, saw an unexpected obstacle to such proposition. He held in the *Victor Battery Case* [4]), that even assuming that it was an illegal contract, the plaintiff Company was not a person for whose protection the illegality had been created by statute [5]) so that there could be relief and that therefore the rule applied which is expressed in the maxim "in pari delicto potior est conditio defendentis". With the respect we owe to Mr. Justice Roxburgh's remark [6]) that "it is not easy to investigate the purposes underlying particular provisions in a statute so complex as the Companies Act, 1929", we submit that Sect. 54 of the Act has as main purpose the maintenance of capital and therefore the protection of the trade creditors above all. The pursuance of other minor purposes, e. g. the equal treatment of the shareholders, does not modify that assertion. There would be a serious loophole in the Law if the Company could not, whilst being a going concern, sue for the creditor's interests it represents by implication, since the duty of maintaining capital is imposed upon it. Be it as it may, the whole question remains on a hypothetical ground as long as the criminal sanction in Sect. 54 remains

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[1]) Compare *supra,* sub I, 2.
[2]) *Victor Battery Co.* v. *Curry's Ltd.,* [1946] Ch. 242.
[3]) Compare Buckley, *op. cit.,* p. 154; Schmitthoff, *The Solicitor,* vol. 14, p 41.
[4]) *Supra,* at p. 243.
[5]) Compare Cheshire, *The Law of Contract,* p. 262; *Barclay* v. *Pearsons* (1893), 2 Ch. 154, p. 166.
[6]) At p. 249.

the only deterrent and the civil consequence of illegality of the contract itself is not generally recognized.

2. It has been held that *any issue of shares at a discount* was to be treated as a payment on account, the member *remaining liable* to contribute the unpaid balance when duly called for [1]).

A rather intricate problem is however to be solved where a person registered under a contract to take shares at a discount, asks for the register to be rectified, with the view to severing his relations with the Company. In a Scottish case of the year 1888 [2]), a member of a company obtained rectification of the Register by the removal of his name therefrom, his contract to take shares "flying off altogether". BUCKLEY [3]) criticizes that decision on the ground that the contract is only "voidable" [4]). The unlawful attempted imposition of a condition (to pay less) in respect of the membership has to be distinguished from the lawful agreement to be a member of the company [5]). The lawful part should be retained and the *rectification should not ensue.*

It follows that the contract, if executed, is binding. The liability to pay the full amount follows from the agreement to be a member upon whom the Law imposes this liability and not from any agreement on the part of the member. We are led to the same result if we adopt the view of BUCKLEY [6]), that no rescission is possible after completion of a "voidable" contract [7]). Moreover, if the contract remains "in fieri" it cannot be enforced.

Whereas the contract to take shares at a discount cannot be enforced against a person who has not agreed to take them, the situation is different if the person allows his name to be placed on the Register, assents to membership and deals with the shares accordingly. Rectification is not possible and the person remains liable for calls [8]).

According to the general rule, *directors* are always answerable to the company for the discount they have allowed. But there is one difference in the extent of their liability from the subjective point of view; if the directors are bona fide they will not be liable beyond the discount; but if there is proof of fraud they may be held liable to pay further resulting damages (which cannot represent more

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[1]) Per Lord WATSON, in *Ooregum Gold Mining Co. of India* v. *Roper, supra,* at p. 136.

[2]) *Klenck* v. *East India Exploration Co.* (1888), 16 R. (Ct. of Sess.) 271; compare WILTON, *Company Law and Practice in Scottland,* p. 179.

[3]) *op. cit.,* at p. 143.

[4]) Apparently not in the technical sense of the word.

[5]) Severance, compare e.g.: CHESHIRE, *op. cit.,* p. 283; *Pickerring* v. *Ilfracombe Railway Co.* (1868), L.R. 3 C.P. 235, at p. 250.

[6]) *op. cit.,* at p. 143.

[7]) If however the member has been registered owing to a mistake which is one of fact and not of Law, relief is to be granted altogether. *Re Almada and Tirito Cp.* (1888), 38 Ch.D. 415 (C.A.); *Re Derham & Allen Ltd.,* [1946] Ch. 31.

[8]) *Re Railway Time Table Publishing Company Ex Parte Sandys* (1889), 42 Ch.D. 98 at pp. 112, 113, which case is to be distinguished from a previous case *(Re Almada, supra)* where the member did not know about the registration and where repudiation took place within a reasonable time.

than the difference between the price paid by the allottee and the presumable value of the shares at the date of the agreement as if it and the transaction founded thereon had never taken place)[1]).

SIXTH CHAPTER

COMPARATIVE REMARKS AND CONCLUSION

1. The analysis of the provisions dealing with the raising and especially with the maintenance of capital shows that *Company Case Law* still plays an important part and that the Companies Acts have only touched it on its fringes[2]) (thus, for instance, Sect. 65, Sect. 54, Sect. 57). *No complete system of liability* can be established and the cases and statutory provisions from which a number of rules can be gathered are in many respects only a framework which renders almost inevitable the presence of a certain amount of loopholes. Where questions of liability are concerned, the English lawyers are often prone to regard *detailed rules* as superfluous[3]). Serious attempts to make inroads into this conception with a view to reduce the margin between the minimum requirements of the Law and the average practice of companies are comparatively rare[4]).

2. This state of affairs is mainly due to the attitude taken by the Legislator at the different periods of reform from the point of view both of legal policy in general and of the choice of the structural elements of Company Law which were regarded as particularly in need of reform.

i) *The strong liberal trends* which have influenced Company Law since the middle of the last century cannot be over-emphasized.

"... We do not believe that it is in the power of the government to supersede the vigilance of individuals who are actuated by the strongest personal interests to detect these frauds... We propose to take now our stand upon the only firm foundation on which the Law can be placed: *the right of individuals to use their own property* and make such contracts as they please, to associate in whatever form they like best, and to deal with their neighbours upon such terms as may be satisfactory for both parties[5])..."

This is part of a speech made in Parliament on the occasion of the introduction of the Companies Bill, 1856, which, as we have seen[6]), was to suppress most of the provisions as to minimum capital, subscription etc., as had been set out in the previous Act of 1855. *The Companies Act, 1856*, can be described as the one whereby *English Company Law irrevocably departed from the Continental conception.*

The non-interventionistic trends have never since faded completely; they have been strongly supported by *psychological* considerations which are sometimes

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[1]) In *Re Hirsch* v. *Sims*, [1894] A.C. 654.
[2]) *Modern Law Review*, vol. 9, p. 236.
[3]) Compare the "*Greene*" *Report* on Company Law Amendment, Cmd. 2657, (1926) p. 4.
[4]) Compare *The Solicitor*, vol. 10, p. 118.
[5]) Hansard, CXL (1856), col. 124: per Mr. Lowe (vice-President of the Board of Trade).
[6]) Compare chapter 4, pp. 37, 38.

neglected on the Continent. Thus English Legislation seems to have been always aware of the danger of detailed, stereotyped and fixed rules which must inevitably diminish *man's sense of responsibility*.

Even the Companies Act of 1948 has kept to the traditional line on points of principle, notwithstanding the social and economic developments which occurred since the previous reform [1]).

ii) The Companies Act of 1856 is important in another respect. It amplified — although imperfectly — the provisions on information and thus laid the base to a tendency which can be observed on the occasion of all subsequent Companies Law reforms: whereas the Continental Legislators are particularly concerned with an appropriate *system of liability*, the English endeavour is to find remedies against abuses on the level of provisions relating to *publicity*. Thus the problem of Private Companies was not debated on the issue of the liability of the members, but on the question of *publicity of accounts*. Publicity has also been the keynote [2]) of the last reform of Companies Law.

Only very few suggestions have been made with a view to alter the mechanism of liability as applied to Public and Private Companies. One proposal, for instance, was to adopt the main principle of the limited Partnership Act for all Private Companies with, say, less than £ 500 nominal capital: one director should be personally liable for the debts incurred [3]).

Apart from the further proposal which recommends criminal prosecution [4]) against fraudulent directors (which is to be regarded as an extreme measure incongruous with the English tradition of non-interference), one more remedy proposed and discussed at some length before the Cohen Committee, is worth noting.

1) "If the directors of a company have reasonable ground for believing that 50% of the share capital has been lost, they must forthwith call a meeting of shareholders with a view to deciding whether the company shall be wound up or whether the business of the company shall be continued or steps for reconstruction taken."

2) "If at any time the directors have reasonable grounds for believing that the company is unable to pay its liabilities to creditors in full, the directors shall forthwith call a meeting of creditors to decide upon the liquidation and the form of liquidation or to accept a scheme of arrangement."

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[1]) The Act of 1948 emanated from the "Cohen" Committee Report the attitude of which has been cautiously described as "progressive conservatism" (*The Solicitor,* vol. 12, p. 158).

[2]) Compare *The Times,* 18th July (1945), "Enterprise and the Law" (leading article) and *The Economist,* 14th December (1946), vol. CLI (5890), p. 958: "The guiding principle of the Bill is to legislate for maximum publicity. It attempts to make financial democracy work through the provision of *more facts, not more controls*... With this Bill, the last excuse for shareholder's lethargy dissappears..." (p. 959).

[3]) *Minutes of Evidence,* (Cohen Committee), Appendix K, 6th day, p. 134; and the memorandum goes on: "It would not prevent dummy directors being named but a creditor would, on enquiry, be effectively warned." This remark shows that even such proposal is again gauged from the point of view of publicity!

From the time of the previous Company Law Reform, in the same line of thought: the proposal that shareholders should be held liable for any debt during the first 12 months (*Minutes of Evidence* taken before the "Greene" Committee, 12th day, No. 2376).

[4]) "*Cohen*" *Report,* § 161; *Law Journal,* vol. 95, p. 313.

3) "In the event of the directors failing to comply with their duty they shall be jointly and severally liable for the deficiency except as regards any director who satisfies the Court that he could not by reasonable enquiry have ascertained the relative facts [1])."

This proposal is again of Continental provenance. The similar Swiss provisions (Art. 725, 754 C.O.) were given as example before the Cohen Committee. Beneficial though the results obtained by such provisions may have been on the Continent as regards prevention of frauds, the English lawyers would not see any appreciable advantage in retaining a provision of that kind. Thus it has been called a somewhat "novel and drastic recommendation" which would place an onerous burden on directors and would prevent a company which was in temporary difficulties from getting back on its feet [2]).

This provision was perhaps not as "novel" as one could have thought, since it was enacted already once in Sect. 13 of the Companies Act, 1855, but had to share the short life of the other security provisions described elsewhere in connection with this same Act [3]).

3. No doubt, just as in Swiss Law, the emphasis in the case of Private Companies is rather on the *protection of the creditors*, while for Public Companies it is on the *protection of the shareholders;* but the means to secure that protection are different in both legal systems.

In the attempt to find some parallelism between English and Continental Law we have to recognize that the *protection of the English creditors* is rather uncertain, if we rely only upon the "statutory mechanism of liability". The striking fact is that no difference is made between Public and Private Companies. Moreover, the mechanism of liability devised for Public Companies is rooted in the well-nigh century-old Companies Act 1856 (when liberalism was at its peak).

The rules which have been grafted upon it subsequently cannot be said to have increased the creditor's guarantee. On the contrary, the *Lee-rule*, for instance, reduced appreciably the protection derived from the principle of capital maintenance which appears to be on the Continent the corner stone of limited liability.

According to English legal policy, as we have pointed out before, the stress is laid on *information*. So much so that in the light of the Statute Book and Law Reports full weight is given to *preventive measures* (publicity requirements), whereas *redress provisions* (a mechanism of liability) appear to be comparatively neglected. It is only possible to preserve—at least in the Statute Book—provisions as to liability which are so much permeated with the doctrine of "laissez faire" because they do not represent the center of gravity of the system as a whole. The further question, whether the differentiated system of publicity requirements in English Law does suffice in all cases to prevent abuses, need not be open to dispute, since the attitude of the English Legislator himself, as we shall see below,

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[1]) *Minutes of Evidence,* (Cohen Committee), Appendix R (1), p. 245.

[2]) *Minutes of Evidence,* (Cohen Committee), 9th day, No. 4351, 4347; *Solicitors' Journal,* vol. 74, pp. 35, 36.

[3]) Compare chapter 4, pp. 37, 38.

proves that it does not. The reason why the English Company Law nevertheless comes near to perfection resides in two very important factors, both outside the Statute Book.

Public Companies, involving big concerns are subject to a whole set of rules provided by the *Stock Exchange*, which are of vital importance for them and complete the provisions of the Companies Act. The Stock Exchange Council goes considerably *beyond the Law* in the strictness of the requirements which it enforces through its own sanctions.

The Legislator is therefore able to dispense with very strict rules seeing that the Stock Exchange regulations can provide accurate correctives.

These regulations do not apply to *Private* Companies. Therefore, it might be surmised that the Private Company, owing to its ancillary position in relation to Public Companies, has been denied appropriate provisions of its own. The commercial practice however has devised other means for obtaining the necessary guarantee. Thus it is repeatedly remarked that the banks, if they are not satisfied, have made it a practice to ask the *directors to guarantee personally* the grant of loan, overdraft or other facilities which they have obtained [1]).

Such banking practice [2]) renders the practical significance of the privilege of limited liability rather questionable; but it establishes a balance of interest to which the Legislator does not seem to have any objection. It appears to be a characteristic of English legal policy to accept that pressure for just dealing and appropriate information is not exerted through the Law only, but that "private regulations can make exceptions in particular cases, while the Law can make none" [3]).

4. Independently of the close interrelation between Company Law and Precedents on one side, and commercial practices on the other, a further factor seems to influence, within limits, English Legislation. It gives an explanation for some of the statutory rules as to liability which appear to be fragmentarily dealt with from the Continental standpoint. The spirit and the purpose of the Companies Act is that those who acquire the advantages conferred upon them through incorporation should conform to its spirit and administer the affairs of the company on the *highest ethical standard*. Therefore the English Legislator provides the citizen with a most efficient instrument for *fair action;* but as far as abuses are concerned he is of the opinion that any system of rules does not prevent every possible machination.

"Many of the suggestions made to us show that the idea that fraud and lesser malpractices can be stopped by the simple expedient of a prohibition in an Act of Parliament dies hard", remarks the "Greene" Committee in its Report [4]).

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[1]) *Minutes of Evidence,* (Cohen Committee) Appendix T, p. 246. Memorandum by the Committee of London Clearing Bankers.

[2]) Ordinary creditors need not do it. They are not "selling credit", *Minutes of Evidence,* (Cohen Committee) 10th day, No. 4848.

[3]) *The Times,* 18th July (5 b), 1945.

[4]) P. 4, No. 8 (preliminary); "and it is probably not dead yet", it has been added 20 years later (*The Solicitor,* vol. 89, p. 473).

APPENDIX I

Because it can be gained from any textbook, we have left aside a systematic and exhaustive comparison of all the respective forms of companies available. The relation between Private Companies, Companies limited by guarantee and the limited Partnership, however, calls for a short comment. At any rate, the significance in English Company Law of the two last mentioned companies is sometimes misunderstood.

The Company limited by guarantee

At first sight it must be conceded that a parallel can be drawn between the liability of the members according to Art. 802 C.O. of Swiss Law and the provisions of the Company limited by guarantee so far as it relates to the liability of the members to contribute an amount specified in the memorandum of Association in the event of the Company being wound up [1]).

The further caracteristics of a Company limited by guarantee, however, do not appear to show any basic resemblance to a Private Company. Thus the Company limited by guarantee may be formed either with or without a share capital. In practice, associations and clubs supported by annual subscription sometimes avail themselves of this form of company, but *without nominal capital.* Between 1862 and 1929, *4155* Companies limited by guarantee have been registered (out of a total of 260 722 companies registered) [2]). Companies limited by guarantee *with a share capital* are extremely rarely registered, being subject to the bulk of provisions applied to any other company with a share capital and the members incurring therefore an additional liability, namely the guarantee, without deriving any corresponding advantage [3]).

The limited Partnership

The limited Partnership is akin to the Private Company in two respects. Both were devised as an association form for the same kind of joint trading; both are contemporaneous with each other as regards their introduction into the Statute Book.

"A limited Partnership is a partnership where some of the partners, on the one hand, are not agents for carrying on the business, and on the other hand, enjoy a limited liability in respect of contracts made and wrongs done by the partners in carrying it on [4])."

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[1]) Compare W. von Steiger, "*Kommentar zur G.m.b.H.*" (1951), p. 8; for the English provisions compare Table C of the Act, 1948; Sect. 21, Sect. 7, subs. (2), (3) of the Companies Act, 1948.

[2]) *General Annual Report by the Board of Trade,* 1930.

[3]) Compare Jordan, *Private Companies,* p. 8.

[4]) Strahan, *On Partnership,* p. 4.

Although it was firmly established in Continental countries long ago, the Limited Partnership (the Société en Commandite, as it is termed in French and Swiss Law) was not introduced into the Law of England before 1907 [Limited Partnership Act, 1907 (7 Edw. 7 c. 24)] [1]).

Traders apparently did not take advantage of this new Act. Instead of a rush, as it was expected, there was a good deal of hesitation. The main reason for that attitude is that the Companies Act of 1907 which gave legal recognition to the Private Company was brought into force on July 1st, 1908. Thus there was only one year in which the Limited Partnership Act of 1907 had a clear run. However, knowing already that a registration as a Private Company which promised to be more attractive would be possible within a short time, the traders preferred to wait until they could avail themselves of it.

The following table [2]) shows that Limited Partnerships are very seldom in use. The commercial community prefers the Private Company with its numerous advantages [3]).

In the year ending:	1908	1909	1910	1911	1921	1925	1930	1934	1939	1945	1946
Number of Companies registered as *Private Companies* .	3018	4982	5419	5194	6291	7955	8512	12 599	10 898	10 775	24 951
Number of *Limited Partnerships* registered	144	121	101	1915 50	64	32	20	25	16	12	28

[1]) Lloyd, *The Law relating to unincorporated Associations*, p. 43/44.
[2]) Figures taken from *General Annual Reports of the Board of Trade.*
[3]) As to Private Companies and Limited Partnerships contrasted, compare e.g. Palmer, *Private Companies*, pp. 94–97.

APPENDIX II

Taxation and Private Companies

An analysis of the intricate problems connected with the taxation of companies would go beyond the scope of our work. However, we should not fail to point out the importance of these questions particularly as far as they are related with the economic significance and the propagation of the corporation.

In Swiss taxation Law it appears that no difference is made between the S. à R. l. and the Société Anonyme [1]).

As compared to the "Société en nom collectif" and the "Société en commandite", the S. à R. l. is in a most disadvantageous position [2]).

In English Law, savings can be effected in certain cases, when a business is converted into a company. Both for income tax and sur-tax, Private Companies may have certain advantages over a partnership. On the whole, however, the advantages do not seem to be appreciable any more [3]).

At present, a heavy burden of taxation is laid both by the distributed profits tax on director-controlled Private Companies and by *death duties* on business assets of the Private Companies. There seems to be a strong need for alleviation in order to avoid many small Private Companies being restricted or even ruined, as they appear to be under the present system of inland revenue assessment [4]).

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[1]) Basle is the only Canton to have conferred recently some small advantages to the S. à R. l. (as compared to the S. A.) in its new Law of the 7th July 1952 ("*Die schweizerische A. G.*", November 1952, p. 68).

[2]) Honauer, *op. cit.*, p. 98.

[3]) Palmer, *Private Companies,* (1950) p. 87.

[4]) *The Economist,* vol. CLXIV, No. 5692, September 27, 1952, p. 782; compare Sect. 55, Finance Act, 1940.

APPENDIX III

Illegal and ultra vires acts

The aim of this short remark is to point out that a much disputed problem resides in the relation between *illegal and ultra vires acts*. Although much confusion has been created by some earlier cases, and by legal textbooks subsequently [1]), the common mistake to give a too generalized meaning to ultra vires acts seems to disappear gradually. Thus, two recent articles [2]) have insisted on a *restriction* of the term ultra vires to those acts which, though not illegal, are unauthorized by the memorandum of association. However, if the acts are contrary to the Companies Law (e.g. payment of dividends out of capital, issue of shares at a discount) they are *void* because they are *illegal*. Thus the true scope of the ultra vires doctrine in English Companies Law should not be overestimated, vexatious though some of its effects appear to be as regards third parties [3]).

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[1]) E.g. PALMER, *Company Law*, p. 51.

[2]) HORRWITZ in *Law Quarterly Review*, vol. 62, p. 73, and *Law Times*, vol. 202, pp. 224, 225.

[3]) Compare *Cohen Report*, No. 11, p. 9. Although the Report recommended its removal, the ultra vires doctrine survived the reform of 1948.

Generally as to the ultra vires doctrine: SCHLINK, "*Die Ultra Vires Lehre im englischen Privatrecht*".